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Fadem Lottery Initiative Proposition 37

Assembly Committee on Governmental Organizations

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ASSEMBLY COMMITTEE ON
GOVERNMENTAL ORGANIZATION

TRANSCRIPT OF PROCEEDINGS

FADEM LOTTERY INITIATIVE PROPOSITION 37

STATE CAPITOL
SACRAMENTO, CALIFORNIA

AUGUST 22, 1984



COMMITTEE MEMBERS PRESENT:

Richard Alatorre, Chairman
Gerald Felando
Richard Floyd
Sally Tanner
Sancia

OTHER MEMBERS PRESENT:

Teresa Hughes

STAFF PRESENT:

Parke Terry, Principal Consultant
Karen Yamamoto, Committee Secretary

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GOVERNMENTAL ORGANIZATION

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PROPOSITION 37

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California Legislature

Assembly Committee

on

Governmental Organization

RICHARD ALATORRE
CHAIRMAN

September 18, 1984

84-10-028

Honorable Willie Brown, Jr.
Room 219, State Capitol
Sacramento, CA 95814

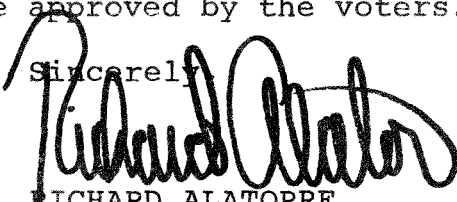
Dear Speaker Brown:

The Assembly Committee on Governmental Organization held an interim hearing in Sacramento on August 22, 1984, to review Proposition 37, the Fadem Lottery Initiative, which will appear on the ballot in November.

The principal focus of the hearing was on the amount of revenue that would be generated for public education and the way in which this revenue would be allocated to local school districts and state institutions of higher learning. In addition, the committee attempted to identify any technical drafting problems, particularly those that relate to security and contracting, which might affect the successful operation of the lottery.

Included in the transcript is a summary of testimony, a policy analysis of Proposition 37 prepared by the committee staff, and a fiscal analysis of Proposition 37 prepared by the Legislative Analyst. The testimony presented at the hearing suggested the need for a "clean-up" bill to be introduced in December should the initiative be approved by the voters.

Sincerely,



RICHARD ALATORRE
Chairman

RA:ky

Encl.

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SUMMARY OF TESTIMONY

Proposition 37 is a constitutional and statutory initiative which would authorize the establishment of a California State Lottery and would prohibit gambling casinos in California of the type currently existing in Nevada and New Jersey. The initiative would create a 5-member California State Lottery Commission with broad powers to implement and manage a statewide lottery system. Net proceeds from the lottery would be earmarked for instructional programs in public education, including grades K-12, the community colleges, the California State University, and the University of California.

The committee's hearing focused on the amount of revenues that would be raised and the procedures for allocating these funds to educational institutions. The committee also sought to examine the initiative closely for possible drafting deficiencies, particularly in the areas of security and procurement contracting, which might adversely affect the operation of the lottery. The committee chairman expressly asked witnesses not to comment on the social and moral aspects of the lottery since the committee had previously taken testimony on these issues.

Mr. John Vickerman, representing the Legislative Analyst, testified that annual lottery sales in California would be about \$50 per capita, or about \$1.25 billion for the state as a whole, once the lottery is fully operational. This volume of sales would yield about \$500 million annually for public education. However, Mr. Vickerman cautioned that this level of revenue would

probably not be realized until the 1986-87 fiscal year when all lottery game formats, including the "lotto" game, were made available to the public. The \$500 million sum would represent 3.8 percent of total current state support for education (exclusive of federal funding and capital outlay). Concerns were also expressed about the stability of lottery revenues over time. In this connection, the Analyst noted that lottery revenues in Arizona, Colorado, and Washington sagged after the initial enthusiasm wore off.

The Legislative Analyst further stated that the initiative's formula for distributing net revenues would provide approximately \$92 per student per year at each of the state's four major educational systems -- K-12, community colleges, CSU, and UC. Under the terms of the initiative this money would be continuously appropriated and distributed directly by the Controller to individual school districts and to each college and university campus.

Mr. Vickerman indicated there could be some unknown loss of revenues due to provisions of the initiative that exempt winnings from the state personal income tax. Also, there might be some loss of sales tax revenues to the extent that any of the \$1.25 billion in projected lottery sales represents money redirected from spending on taxable goods. The Analyst could find no "hard" evidence that lotteries noticeably reduce parimutuel horse racing revenues.

It was noted that the intent of the initiative (Section 8880.1) requires that net revenues from the lottery supplement

the total amount of money allocated for public education in California. However, since the Legislature must ultimately decide the total funding need for education, Mr. Vickerman said it may be difficult to determine whether the lottery revenues actually added to the level of funding that the Legislature, in the absence of a lottery, would have appropriated.

Mr. John D. Quinn, Director of the New York State Lottery, was invited by the committee to comment on the initiative from the perspective of a person responsible for managing a lottery system in a large urban state.

Mr. Quinn presented an overview of the New York Lottery and compared some of its features with the California initiative. He stressed that the lottery would be a big business with gross sales and revenues comparable to the sales and earnings of the nation's largest corporations.

Mr. Allen Sumner, representing the Attorney General, testified on security issues. He expressed concerns about the lack of specific security protections in the initiative and the fact that many security matters would have to await the adoption of regulations by the commission.

He also expressed concerns about the 135 day start-up period, particularly whether the commission could make background checks on its employees, vendors, and agents within that time frame. Mr. Sumner noted that the initiative does not authorize the director or deputy director for security to obtain criminal history information ("rap sheets") on persons who would be hired by or contract with the lottery commission. He also noted that

the role of the Attorney General in the lottery is unclear. He conceded, however, that these problems could be resolved through appropriate amendments to the act. (NOTE: The act permits amendments "to further its purpose" by a bill passed by a two-thirds vote of the Legislature and signed by the Governor.)

Ms. Nancy Sweet, also representing the Attorney General, commented on the video lottery terminal issue. She said the Attorney General was aware of the Legislative Counsel Opinion (#7290) which questioned whether video lottery terminals (electronic devices similar to arcade games in which the player inserts a coin and attempts to win a voucher or coupon good for cash or prizes) would be allowed under the initiative. She said the Attorney General's Office had not researched the issue or issued a formal opinion.

Mr. Charles Casey, Chief of the Bureau of Organized Crime and Criminal Intelligence of the Department of Justice, was critical of the lack of oversight mechanisms and checks and balances within the initiative. It was suggested that many of these problems might be corrected through the adoption of regulations. However, Ms. Sweet stressed that the initiative exempts regulations of the lottery commission from the normal administrative law process, including public notice of proposed regulations and review by the Office of Administrative Law. Consequently, there would not necessarily be an opportunity for the Attorney General to comment on these regulations or to offer suggestions as to how security could be improved.

Mr. Gilbert Marguth, Deputy Superintendent for Administration of the Department of Education, told committee members that Superintendent Honig has taken a position of neutrality on the lottery initiative. He expressed fears that the public may assume that the problem of inadequate educational funding has been solved by the lottery. In fact, he said, the \$400 million that would be provided to K-12 education from a lottery would not come close to approaching the needs identified by the Department of Education.

Mr. John Babich, representing the Department of General Services, confirmed that the lottery initiative was drafted so as to bypass the normal management and control functions of the Department of General Services. These functions include centralized procurement purchasing, review and approval of contracts for services and consulting services, space management, and acquisition of real property. Mr. Babich also noted that the initiative exempted the lottery from the state's competitive bidding procedures and from the Small Business Procurement and Contract Act. He added, however, that the commission could agree, at its option, to comply with these laws. Mr. Babich further stated that it would be difficult for the lottery to begin operations within 135 days if it had to comply with the normal state bidding procedures.

Mr. Barry Fadem, representing Californians for Better Education, defended the initiative. He said the initiative was drafted so that the lottery could operate as a business. This required exempting its operations from many of the control

mechanisms normally applicable to state agencies. He doubted security issues raised by the representatives of the Attorney General would be problems since the lottery would be operating under close public scrutiny.

Mr. Fadem maintained that the 135 day start-up deadline was feasible and had been met in 10 other states. He added that the lottery would be producing about \$2 million a day for education and that delayed implementation would reduce potential revenues.

With regard to the amount of revenue that would be generated by the lottery, Mr. Fadem questioned some of the assumptions used by the Legislative Analyst in arriving at his \$500 million projection. Mr. Fadem asserted that the proponent's estimate of \$680 million is "conservative" and "supportable" based on the per capita sales experience of Colorado and Washington.

Mr. Fadem also testified that it was the intent of the sponsors to allow video lottery terminals (VLT's) as part of the proposed lottery system. He disputed the Legislative Counsel's opinion and pointed out several sections of the initiative that make VLT devices permissible.

Ms. Nancy Jenkins, representing the California State PTA, raised several questions about the initiative's impact on education. Among her concerns were that lottery revenues would supplant monies from other sources, that local school districts would be unable to use lottery revenues for needed capital outlay purposes, and that districts might commit lottery revenues to on-going programs and find later that the revenues fluctuate widely or terminate because of a scandal. She also expressed concerns about access to video lottery games by minors.

Mr. Trevor Thatcher, representing Games Management, Inc, recommended that California move quickly to institute a "lotto" game. He said the lotto game is the fastest growing form of lottery in the United States. He added that lotto would help stabilize revenues after the initial interest in instant games wears off.

ASSEMBLY GOVERNMENTAL ORGANIZATION COMMITTEE

FADEM LOTTERY INITIATIVE

PROPOSITION 37

ASSEMBLYMAN RICHARD ALATORRE: The Assembly Governmental Organization Committee is now called to order. The purpose of today's hearing is informational in nature. I am not interested nor is the committee interested in listening to proponents or opponents of the lottery. The purpose of the hearing is to get information, to focus in on the manner on which the initiative was drafted. If there are any deficiencies in the drafting, to listen to parties that have had experience in the lottery. We will be listening to the director of the lottery from New York. We will listen to the Legislative Analyst who will talk about the revenue implications coming out of the lottery as well as the individuals that will benefit by the representative of the Department of Education as well as the drafter of the initiative. At this time let me introduce to you who will be speaking from the Legislative Analyst. The Legislative Analyst for an overview of the lottery initiative and the fiscal effects.

JOHN VICKERMAN: Thank you Mr. Chairman. I am John Vickerman, Chief Deputy in the Legislative Analyst's Office and I have with me on my right David Vasche who is the Senior Economist of our office. I have a prepared statement which I will summarize and I assume it is before you. You have asked us essentially to do two things. First, give a brief overview of the legal provisions in the measure. Second, to respond to eight specific questions directed to our office.

Going to the main provisions of the initiative. This initiative covers both constitutional and statutory measures. The main constitutional provisions are it allows a lottery. As you probably know, since 1849 we have had a provision in that constitution that has prohibited a lottery. So this repeals that. Secondly, it prohibits on a constitutional basis casino-type gambling that exists in Nevada and New Jersey. We have a statutory provision in current law so this elevates the statutory to a constitutional provision -- most of the provisions that govern the lottery and the statutory measure that is also incorporated therein.

On page 2 of our statement we go into the general part of these statutory provisions: (1) The measure establishes a state lottery commission and gives it very broad powers to oversee the operation of a lottery. For example, the commission would be responsible for determining the type of lotteries; (2) the frequency of drawings; (3) the price of lottery tickets; (4) the number and the amount of lottery prizes; and (5) the location where the tickets will be sold.

So none of these are spelled out in the initiative. It is going to be the administrative direction of the lottery commission to determine some of these characteristics. I point that out because what the commission does is going to effect the revenue effect that we talk about later on. At this point in time, we sort of are in a position of having to second guess what the commission might do next spring.

Second, the measure provides that the commission shall have five members and a lottery director. All of these six people shall be appointed by the Governor and confirmed by the Senate. It specifies that one of the five commissioners (these are part-time jobs) shall have a background in law enforcement and at least one shall be a CPA. It does not specify about the other three, but it does say that no more than three of the commissioners shall be from the same political party.

Down on the bottom we talk about the implementation of a lottery. There is one very unique feature and that it says that lottery sales have to begin within 135 days of when this measure will become effective. So we are saying essentially that they have to begin sales by April 1985. As you know from your previous hearings there are essentially three types of lottery games: (1) the instant which I call the McDonald type where you have a card and you scratch it off and you find out if you are a winner right away, (2) the number type games which are daily drawings which are very popular in the mid-west and east, (3) the lotto games which is the newest and the fastest growing form of lottery.

From the information that we have gathered from other states, probably the only game that could meet the 135 day limit is the instant game. These were the first games that were established in Arizona, Colorado, and Washington which are the three western states with lotteries.

This measure also provides that lottery tickets can only be purchased by people 18 years and over.

Third, it provides \$16.5 million temporary line of credit for initial start-up costs. This is a general fund loan that has to be repaid at 10% interest and you have to pay within one year of the time you draw out the money.

ASSEMBLYMAN FRANK VICENCIA: I had discussed earlier with some other people about this very question of the initial start-up monies. It provides that the commission would, from the General Fund, acquire \$16.5 million temporary line of credit. What kind of a position does that put the Legislature in? Are they required to give them that money?

MR. VICKERMAN: I would assume so, yes.

ASSEMBLYMAN VICENCIA: That's the way you read it?

MR. VICKERMAN: Yes, that's the way I read it.

MR. ALATORRE: Is there continuous appropriation?

MR. VICKERMAN: Yes. They have to draw on it within the year of the effective date. Then from the time they draw they have a year to pay back. So theoretically you could be 23 months, for example, before the last payment would be made.

MR. VICENCIA: But is this an initial \$16.5 money or is this...

MR. VICKERMAN: Initial. On Page 3 we talk about what this measure specifies of how you distribute the proceeds. Essentially it is 50% for prizes, up to 16% for administrative costs, including the commissions for retailers and at least 34% for public education. That 34% can increase to the extent you do not spend the 16% for administration or to the extent that you have unclaimed prizes. We will talk about that later where in

our estimates we assume on an on-going basis that education can get 40% of the proceeds on an on-going basis.

On the bottom of the page we talk about how the money is distributed. Essentially there are four categories of public education what will benefit from this money: K-12, Community colleges, state colleges, and the University of California. So it is not just K-12, it is all four segments of public education in California.

There is a key point on the top of Page 4. The initiative specifies that it is the intent that lottery funds shall be made available are to augment rather than substitute the funds already allocated for public education. You will probably hear more discussion of that later on.

ASSEMBLYMAN ALATORRE: Is there any way to bind the Legislature to do that?

MR. VICKERMAN: I don't think so, sir. I think that lottery money is to go out. That is not going to be the debate. The debate is -- What is your normal spending for education and how closely do you have to be geared to that? For example, you have statutory COLAs. Well, the Legislature didn't use statutory COLAs in the past. You have some of your education that doesn't have statutory COLAs so there is no absolute fixed amount of money that has to go for education year in and year out, regardless of the budgetary situation. So you could have a situation where you give a 5% COLA for education where the law says 6%. I think probably nobody would dispute that you are not taking money away from the lotteries. That is where the fight is going to be, if there is a fight.

The next part of our analysis goes to the specific eight questions that you asked our office. Are there any questions before I get into that part?

ASSEMBLYMAN ALATORRE: No, that's fine.

MR. VICKERMAN: The first question: How much net revenue would the lottery produce for education? On the bottom of this page we talk about the percentage and as we say on an on-going basis from the experience in other states, if you take the 34% you add in what we think would be a portion of the administrative cost that would not be used and you add in the unclaimed tickets and you are talking roughly about 40% on an on-going basis. You are not going to have that kind of percentage initially because of start-up costs, equipment purchases and a lower volume.

Second, on Page 5 we talked about what is the volume of ticket sales. The first point is we at this point don't know what the commission is going to do. How many of these three different types are they going to put in? When are they going to come in? All of these things are going to affect how generous are they going to be in pushing the lottery. The lottery has a provision that you shall maximize revenues, but there is a wide latitude and discretion to the commission of how effective or how much are they going to promote this thing. So what we did is rather than looking at legal provisions, we looked at the provisions in other states and they give you some guideline of what might happen in California.

Also, we looked at the fact that lotto is the newest form of the lottery game and is also the fastest growing. So we have

been looking at these statistics over a period of years and you will see later on on Page 7 we give you the statistics for the last two fiscal years. For example, total lottery sales grew from \$5.2 billion in 1982-83 to \$6.8 billion in 1983-84 a very rapid growth and part of that growth is pretty much the introduction and the full year effect of your lotto games. Some of the other states are bringing in lotto on-line this fall.

ASSEMBLYWOMAN SALLY TANNER: What is lotto?

MR. VICKERMAN: Lotto is..well you have probably seen in the newspapers where somebody wins \$20 million in New York. What essentially is the characteristic of the game is you pick six numbers out of 40 or 44 and you have very few winners. There are weekly drawings and if somebody doesn't win one week, then the money goes over to the next week and essentially anybody who has these six numbers gets the prize. They normally...

ASSEMBLYWOMAN TANNER: And the difference in lottery is you draw a number...

MR. VICKERMAN: No. There are as I say, three types of games. On the instant game you have a lot of small prizes. Ninety-nine percent of your winners are getting \$5 or less in one of the games in Washington. But instant games, they will play maybe a couple of months. They will sell say, \$50 million in tickets. Whenever those tickets are sold, that stops that game and you start another game. But it is a lot of small winners and a few large winners. Numbers games you pick three numbers and there are daily drawings. They are smaller prizes. You don't have the million dollar prizes. Lotto is the other extreme that

is weekly drawings, but essentially what you have is very few winners and the pot is big enough you have very big winners.

ASSEMBLYWOMAN TANNER: It's a numbers game, though.

MR. VICKERMAN: You pick six out of...Yes, it's a numbers game.

ASSEMBLYWOMAN TANNER: Okay.

ASSEMBLYMAN ALATORRE: Continue..

MR. VICKERMAN: When we look at all these factors, we decided that the best approach for projecting California revenue was to look at not all the states, but look at the large industrial states and the states that are geographically close to us. And also make an adjustment for the fact that about half of your lottery sales nationwide are from numbers games and numbers have been popular for decades in certain mid-western and eastern states, but they haven't had a history in California.

For example, only one western state has a numbers game. That is Washington. They established it last January. Sales have been very disappointing. So probably the games that would be very popular in California would be instant and the lotto. But we have some questions whether the commission would establish numbers and how popular that would be in California.

As you see from Table I on Page 7, on a per capita basis, sales among all 18 jurisdictions were \$50 per capita in 1982-83, \$64 unweighted in 1983-84, but there are wide variations in these revenues from a low of about \$10 in Vermont to a high of \$157 in the District of Columbia. We picked a figure which we thought was most representative and that would be about \$50 per capita.

That's for every man, woman and child in California and that would have lottery sales total of about \$1.25 billion when it is fully operational. Then using the 40% figure that we talked about before, that would produce education revenues of about \$500 million a year when it is this fully operational. I will go into some of the other features below, but we did not estimate what you are going to get in 1984-85 because you are only going to get three months of revenue. Second, we did not estimate what you are going to get in 1985-86 because we assume that this is when you not only have your first game, but you have partial implementation to your second game. So what we tried to do is estimate the on-going revenue effect when you have your full set of games which would be 1986-87, which is really a third year.

Now our estimate is lower than those by the proponents and you have asked us to compare our two estimates. I have seen several estimates by the proponents. I don't understand the math of the \$700 million revenue estimate. I have seen figures close to that. My information is that they arrived at their estimate by taking per capita sales figures in two states, Washington and Colorado, and then adjusting that somehow for California revenues. We find a couple of problems with that approach.

First a sample of two is pretty limited. Second, when they use the initial start-up figures in Washington and Colorado, they were much higher than the second year figures. Let me give you an example. The first 5½ months that Colorado had its lottery, its monthly sales volume was \$26 million. The next 12 month time period, their monthly sales volume dropped to \$9.8 million.

You had a similar pattern in the state of Washington. The first 7½ months that they had lottery sales, the volume was \$26.7 million. The next 12 months it was \$13.7 million. This is fairly common when you have a new game like this come on that there is a lot of enthusiasm, a lot of interest, but you don't keep the same volume after it stabilizes a little bit.

ASSEMBLYWOMAN TERESA HUGHES: (inaudible)....Why is it that the District of Columbia seem to have doubled the....

MR. VICKERMAN: You have a part year effect in 1982-83, Mrs. Hughes. That's when they introduced the lottery. I think the District of Columbia's figures are somewhat distorted because you have more people buying than just people who live there.

ASSEMBLYWOMAN HUGHES: So that is certainly true of any state because I recently went to Montreal, I bought, not a lot. I went to New Hampshire, I bought. I went to New Jersey and New York so anybody traveling through these states can buy and you don't even have to live there to buy it. Does the District of Columbia have more lottery games than do the other states that their figure could reflect more travelers?

MR. VICKERMAN: No, they don't. I think Jim was right. I understand, Dave can correct me, I think they only have instant now and they are coming out with lotto. I don't know if they have numbers.

ASSEMBLYWOMAN HUGHES: So, in other words, if we increase our tourism in this state, we also increase our revenues for lotteries, right?

MR. VICKERMAN: Could be.

ASSEMBLYWOMAN HUGHES: Yes, thank you.

ASSEMBLYMAN ALATORRE: But, also Washington, D.C. is close to Virginia. Virginia doesn't have a lottery so they probably get the spill over of people living in Virginia.

MR. VICKERMAN: On Page 9, we go to your second question: How much would go to education and how would it be distributed? In the middle of that page, we are assuming that the way we read the measure that it would be an equal amount of \$92 per ADA or per full time equivalent. Under that reading, 80% of the money would go to K-12; 13% would go to community colleges; 4.5% would go to state colleges; and 2.4% would go to U.C.

ASSEMBLYMAN GERALD FELANDO: What guarantee is there of that?

MR. VICKERMAN: I think there is full guarantee because the money automatically goes out...

ASSEMBLYMAN FELANDO: To where?

MR. VICKERMAN: The State Controller and he allocates...

ASSEMBLYMAN FELANDO: Where does it go first? Does it go into the General Fund?

MR. VICKERMAN: No. It goes into the special lottery education fund.

ASSEMBLYMAN FELANDO: Don't we have a special environmental license plate fund?

MR. VICKERMAN: Yes, sir.

ASSEMBLYMAN FELANDO: What happens to that money?

MR. VICKERMAN: That is appropriated by you, but this money goes right to the State Controller and the measure...

ASSEMBLYMAN FELANDO: What assurances are there that this grubby Legislature cannot get its grubby hands on that money? I want to know that.

MR. VICKERMAN: Well, let's turn it around. The measure provides continuous appropriation. The proponents argue that this money or the administrative expenses are not subject to legislative review, which is rather unusual. I have had some informal discussions with Legislative Counsel on this issue and they say the issue is not clear....

ASSEMBLYMAN FELANDO: That answers my question. That means that this Legislature, at any time can get its hands on that money and spend it for anything that they so desire.

MR. VICKERMAN: Absolutely not. No, let's go back....

ASSEMBLYMAN FELANDO: Now you said yourself that Legislative Counsel had some questions about..

MR. VICKERMAN: I'm talking about the budgeting.

ASSEMBLYMAN FELANDO: I understand that.

MR. VICKERMAN: No, there are two issues. One is budgeting of the administrative expenses the other is this is a constitutional initiative and it says that it can only be amended by the Legislature to further its purpose. My discussions with Counsel say to change who gets this money or to change the fact that you would change from a state operated lottery to a private operated lottery, they do not read it as furthering its purpose. So I do not see and you can ask Counsel, that my reading of this measure is the money is definitely earmarked for education and this legislative body cannot change that. Only another vote of the people could change that.

ASSEMBLYWOMAN HUGHES: I have a question along that line. I had a piece of legislation that stated that any money that the Legislature normally allocated for education would be only supplemented by the revenues from the lottery. Could we, in fact, since this lottery goes in effect April 1985, when we come back in January have legislation that, would that legislation have any effect on that initiative?

MR. VICKERMAN: This measure has the same provisions, Mrs. Hughes. It says it shall supplement...

ASSEMBLYWOMAN HUGHES: And not replace...

MR. VICKERMAN: Not replace. And shall be used for instructional purposes only. Not research and not capital outlay. It's right in the provision.

ASSEMBLYWOMAN HUGHES: Thank you. Sounds pretty good.

MR. VICKERMAN: On the bottom of Page 9 we talk about how much would be allocated and really the key details are on Page 10 where we show the distribution of the \$500 million on-going revenue for education. Then we compared those amounts to how much is being spent in the current fiscal year to give you some kind of comparison. In other words, \$400 million would be the equivalent of 4.2% of state money for K-12 -- 3.8% of the total state money for all public education. Now these figures do not include local property taxes, federal money, or capital outlay funds. I don't have the figure written in my text, but the amount per ADA or FTE is about \$92.

ASSEMBLYMAN FELANDO: So what's to prevent the Legislature from saying, well okay we know we are going to get \$500 million

next year from the lottery game so this year, instead of appropriating \$1.2 billion for education, we are going to appropriate \$800 million. That's still a supplement. The \$500 million is still a supplement, it hasn't replaced anything.

MR. VICKERMAN: I'll let the lawyers argue about that. I think the more practical impression you will face is rather than giving say a 6% COLA you gave no COLA. And then would the educational community say that you violated the provisions of this initiative. Because you went to the extreme where you actually cut the level and if I were on the other side as a lawyer, I think I would have an easier chance of saying that you did violate.

ASSEMBLYMAN FELANDO: Or instead of cutting, we don't increase. We just don't increase. We just fix it a \$1.2 billion and then let the lottery take care of anything...

MR. VICKERMAN: The actual situation would depend on how you treated education versus how you treated everybody else. You know if we had another fiscal crisis like we had a year or so ago where practically nobody got increases. If I were in the Attorney General's Office, defending the Legislature, that is the normal level of education funding for this particular year and we didn't discriminate against education versus welfare versus state employees.

ASSEMBLYMAN FELANDO: See, but the problem is, over the last 10 years education really hasn't fared too well in this state, and I am not so sure that this measure changes anything. I think proponents would like to have the people in the state of

California think that this proposition really is going to change something, but I really have my doubts about it. There aren't any guarantees that it's going to change the total appropriation in the state of California for education. I think it's misleading.

MR. VICKERMAN: Well, I can tell you two things. One, the money that will be raised by the lottery will go to education. Two, there is no automatic fixed 100% guarantee of how much education is going to get next year or the year after anything else. So you have a judgment factor...

ASSEMBLYMAN FELANDO: That's why really it's a sham. If the Legislature and the Governor want to do something about the funding of education, they should come up with a formula for a fixed funding of education in the state of California.

ASSEMBLYMAN ALATORRE: Mr. Felando, we can't argue what the Legislature should do or not. He is here to respond to the questions that we asked about the lottery.

MR. VICKERMAN: On Page 11 we talk about the stability of lottery revenues over time. We looked at it from two points of view. First on the long-term basis. To try to shorten up my testimony a little bit, we have seen evidence that they sag after time, after initial enthusiasm glamor wears off -- there is some sag unless you introduce new games, or something else that keeps the thing going.

Next on Page 12 we looked at the short-term effect and that is how much the lottery revenues are affected by the business cycle. We could see some evidence that they are -- probably less

so than some of your General Fund taxes. They are not 100% stable. Other influences affect them, but of course the bank and corporation taxes are also very volatile. Sales taxes are volatile and income taxes less volatile. So I think it's probably less volatile than the three major sources, but they are influenced by economic conditions.

Page 13 we talk about the allocation proceeds in other states and on Page 14 we give you a table showing how the money is allocated in the 18 other jurisdictions. I would caution you some of the smaller states, the figures are not that meaningful, they have small bases. For example, Vermont spends 44% of its proceeds on administration. That's because it has a very small lottery. If you take out some of these smaller states and the start-up costs you'll find out, and that's the bottom line, about 49% goes for prizes, 10% goes for administration, and about 41% goes for public purposes which is pretty much the distribution that this measure proposes.

On Page 16 we talk about state revenue losses due to the tax exemption of lotteries. We can't give you a good figure because first we looked as if you said all right everything that lottery wins is going to be subject to 11% rate, that would be a figure of \$70 million you would lose in state revenues. But as I mentioned before, 99% of the lottery winners in an instant game could be \$5 or less, that's 66% of the money. That is not going to be taxed at 11%. So it depends on the type of game you have.

Secondly, typically the states from the large prizes like lotto pay them out over 20 years primarily for federal tax

purposes. You'll get the money if it's big enough at 11% rate, but you won't get it all in one year. You get it over a series of years. And when you talk about the economic effect of this measure drawing \$1 billion out of the income stream and redirecting it to other purposes, we can't give you a good answer of how that affects state revenues because part of it, you know, what happens to the dollar that I was going to spend over at the drug store versus my putting a dollar here.

Then secondarily, if the teacher gets half of that dollar, what are they going to do versus what I am going to do. There are just too many imponderables in the equation.

On Page 17, you ask what effect would there be of parimutuel wagering. The way we look at it -- there is some substituting ability in all these types of gambling. But frankly horse racing is a much better gamble than a lottery. About 80 some percent of the horse racing money goes back to the bettors and you have some control over your destiny when you're betting on horses. People I talked to that like horse races look at the odds and a lot of the lotteries they sort of pass. You get the dollar in and you get back what they give you. So the bottom line is we checked with the 14 other states that have both lotteries and parimutuel wagering. We checked with the horse racing board rather than the lottery boards to get a little better perspective. Eleven of the states didn't think it had much effect, the other three states said it's possible, but they couldn't give any indication of how significant it was.

The last question that you asked was what effect it would have on sales tax revenues. It is somewhat like the same question you had on income taxes. Sure, there might be some redirection of sales tax revenues to the extent money is spent one place rather than another. You might have some increased sales tax revenues from equipment purchases and everything else. We cannot give you a bottom line and I don't think anybody else can. I'll be glad to ask for any questions.

ASSEMBLYMAN ALATORRE: Are there any questions from the members of the committee? Okay, thank you very much. Mr. John Quinn, New York State Lottery.

MR. JOHN QUINN: Mr. Chairman, ladies and gentlemen, I appreciate this opportunity to appear before this committee and hope that some of the things I might offer might assist the state of California in event the petition that has been submitted is approved by the electorate. My name is John D. Quinn, Director of the New York State Lottery.

Mr. Chairman, I have read but not studied the initiative. I would like to first give you a little bit of background that may help understand some of the answers to other questions that I will respond to or touch on in this background.

I was born in New York City. Went in the army when I was 18, 1946 and retired from the army in 1970. The last six years of military experience was in computers which indirectly leads to my being here today. My retirement from the army, I worked for Republican Governor, Governor William Milliken in Michigan as part of a management sciences group to develop a statewide data

processing plan. As part of this position, the Governor asked me when a referendum was pending would I look into state lotteries since he needed someone on his staff that knew something about it. So I went and visited all other state lottery seminars and so forth and when the referendum was passed, I requested the Governor to assign me to the lottery and he did that. I worked there from 1972 to 1976.

In late 1975, the New York State Lottery got in trouble. It was suspended by former Governor Hugh Carey on October 22, 1975. There were charges of fraud and mismanagement leveled, duplicate ticket printing, and so forth. So I worked for the governor and told him I was a native New Yorker and if he was going to change management, I would like a shot at being considered. He did that.

I went to work there in April of 1976 and we started sales again in September 1976. The loss at that time to the state of New York of suspending the lottery was \$44 million. If that same 10½ month loss occurred today, the loss would be about \$331 million. So it is just a factor of the changed sales level that would make it much more significant if it happened today.

Only one condition and this is by way of the purpose of my being here is to offer advice to the state of California. I only made one condition with the state of New York about moving from Michigan. And it was, if I were to move, I wanted to be promised that there would be no political interference in my operation of the lottery. I did not want the governor or the Legislature telling me who to hire and who to fire and that sort of thing.

If they wanted a professionally operated lottery without relationship to politics, then I would be willing to come. I am neither a Democrat nor Republican which me anathema to both parties. But nevertheless Governor Carey and the Legislature and Governor Cuomo and the Legislature since that time have abided by that and it has helped in the New York state lottery because politics was part of the cause of the demise of that lottery.

The records indicated that there were about 440 people on at one time and every time you hired a Democrat, you had to hire a Republican. A lot of the jobs were no show jobs. As opposed to a strength today of 210, 440 then many no show jobs were involved in it and it was really a sad situation. I am pleased that part of it worked.

We did make progress in the state of New York. In gross terms we were the second state to do \$1 billion in sales, Pennsylvania was first. This year we targeted to turn over to the state of New York \$520 million in this fiscal year. It will probably be closer to \$560 or \$550 million, in that range. We are doing very well in gross sales. In terms of per capita sales we are about in the low middle. We don't do that well in per capita sales.

This year we expect to do \$1.2 billion in total sales which comes out to, dividing by 17.5 million, about \$68 a head per capita. Weekly it comes to about \$1.30 and there are several states that are up in the \$2 plus per capita. You might say why is that. Well it is because we are surrounded by competition. We have the heaviest illegal gambling of any state in the United

States. I don't know what San Francisco or Los Angeles has, but I doubt it can compare with New York City. This is very open and blatant in some places -- the competition. It is that competition plus we are entirely surrounded by lottery states or the provinces in Canada. There is lots of competition there.

In brief, Mr. Chairman and ladies and gentlemen, the New York State Lottery has, the California lottery will be if the initiative is passed, a big business operating within a bureaucracy. To give you an idea of how big it might be, if we were rated in the Fortune 500 of the top industrial corporations in the United States last year, we would have been 321A in sales and we would have been 42A in revenue. That is in revenue as compared to the top 500. So it is a big business operating within the constraints of a bureaucracy.

Now some points that address some of the issues that you have in the initiative...

New York State does not have a commission. It is one of four states that does not operate with a commission. The others, to my knowledge are Michigan, Pennsylvania, and Delaware.

Will a commission work? Certainly it will work. Of the 18 jurisdictions in the United States, it is working in all those others. Most commissions work well. I personally would prefer to operate without a commission as I have for the last 8 years in New York because the lines of communication are shorter and when you are making decisions you can do it easier, but there were times when I had wished I had a commission to sort of insulate the lottery against some of the outside critics and some of the

major problems that we were having. But one of the questions was would it work and certainly it will work and I think a new state with all the attention of the media and with all the attention of the police activities, at least is demonstrating to its citizens that yes we have many more minds that work on this.

Again, I would just conclude this point by saying individually, I prefer to operate without one, but I think for the state of California and a new state, it is probably the way to go.

I have given some handouts, Mr. Chairman, which talk about the organization of the lottery, and I am not going to go into that in great detail. We have three bureaus plus a field staff. The New York State Lottery now consists of about 210 persons. About a third of them are in the field -- New York, Buffalo, Syracuse, Utica, and two-thirds are in upper Albany, the central headquarters. We have a good law that we operate under.

Technically, I am part of the tax department. Actually I report directly to the Governor's office. So there is no problem there, but going through that. I am not heavy in dealing with the Legislature. I noticed several of the questions that were posed and several of the comments so far.

When we deal with the Legislature, it is normally through the Governor's budget office. I rarely go over and try to push a piece of legislation through. I don't have that many pieces of legislation to go through. The lottery has a good law that it started with. But when we want to change something, I normally don't get involved in that. I go through the Governor's office

first. He will either include it in his program package or let it go as departmental legislation and then the budget department will pick up the ball on that.

As far as budgeting, this is something that falls into the question areas and that question is how can the Legislature exercise control? The Legislature in New York appropriates a portion of my budget each year -- a portion that pertains to the operating costs, my real estate costs, and things of that nature that I have to have to operate. So they control in that way -- that is not the total budget, however. One of the charts that you have there indicate that it is about \$33 million that they have appropriated this year. Yet the total budget, when you include paying all of the agents the distributor fees and so forth, are about \$114 million which \$33 million is appropriated and the rest comes from percentage factors based on sales.

Reports. That was one of the statements that was made. How about these reports that have to be made? The reports that I make are annually to the tax department and to the Legislature, although my reports to the Legislature are more frequent based on specialized subjects.

I report monthly to the Governor and this is basically telling how programs are going and don't get into a lot of sales figure details and things like that. My weekly sales report and my weekly projection report goes to the Governor's budget division which then cranks that into the statewide budget picture. We do not send any reports to the Attorney General. I report annually to the public and one of these is attached to

that (pointing to handout) just because we feel we owe it to the public to let them know where the dollars are going each year. It is either once or twice a year. It looks like that (holding up report) in your package -- the Seventh Anniversary Report. It tells them how much money we have made, where it is going to, and then answers to questions often asked about the New York State Lottery. We get good response to this and the people like it.

To address an issue that was brought up with the last speaker -- dollars to education. Originally, in 1976, when the lottery was restarted, it was written essentially as you have it now -- that it would be supplemental to normal appropriated funds for education. However, that was changed the very next year so that it now is included as part of the budget package, or I suppose the term you use out here -- supplantation. The example being something as the gentlemen over here was making.

In New York state aid, let's say, is \$5 billion this year. It is a little more than that. We are projecting we will make \$520 million and we will make more than that, but just to use the figures we are projecting. What happens in New York is that \$4.480 is appropriated and they look to the lottery to generate the other \$520 million.

So that responds to another question that you had -- Is it related to educational expenditures? It definitely is in New York because they have to determine what that upper state aid to education limit is that they are going to prove for the year and they back it up by a reasonable estimate for lottery expenditures. If I estimate \$450, the Legislature normally says

I can do \$500 and if I say \$500, they'll say \$550. I hate to admit it, but they have been right so far in most of the cases. I have been giving conservative estimates because I have been burned a few times in the early years. When I thought I would do better than I would, and we didn't do that well so I tended to get conservative. But normally the Legislature will add something to it, and we we have been able to reach that and exceed it.

On this budgeting system where you included as part of the major budget, the public frequently will ask the question when I do a radio or T.V.media presentation -- Why if you are making so much money in the lottery are our taxes still going up? And the response that I normally provide is -- Look, this year we are going to do about 10.5% of the state aid to education, \$520 million. But there is still another 90% that has to come from some place else.

The lottery was never intended to provide all the expenditures for education and people should understand that. It was provided to ease the burden. At least in New York it was provided to do that, and I am certain, although I am not familiar with your educational budget figures, that you are talking numbers like that. So it can only provide part of it. It can never provide all of it.

The question on vendor review, all of these disclosures. In one hand you can say we ought to have disclosure about everything. On the other hand you have to recognize that there is a cost involved anytime you do that. You can have a room full

of paper if you wish, and it would be nice and protect you in cases where you might need that. The director and the commission in this state will have to decide how much they need.

On our major vendors we get information. The first time we deal with them we get information, for example, finger print cards, background checks, things of that nature. We get their annual reports. On the lesser agents, the guy we are doing a contract with on pencils, we are not going to go through all that trouble if he is selling us 2,000 gross of pencils, but our major contractors we get the background.

We have not gotten income tax returns similar to what is suggested. I can't say that is a bad idea. I can say that probably a new lottery with all the attention on it, I would probably go for the same thing that there is now. We don't do it, and we haven't done it. The best I can tell you is the proof of the pudding is in the eating.

We have had only one case with a major contractor where we had a problem. This was where the fellow that had a contract with the old lottery before I took it over. I tried to cancel it, and the lawyers told me I couldn't cancel it. Subsequently, as I started looking into it, we found out that he had contacts with some people that weren't so nice. Then I cancelled the contract and he took us to court and he did not win the case. We are ahead on that one.

So I think on the amount of coverage that you have on the agents, for example, we do not finger print all the agents. What we do is get a detailed background check on our on-line agents

and on the smaller agents. We automatically give them a temporary license. If their completed application indicates that they have convictions in the past, then we will get a more detailed breakdown.

Media relations. I think you have to be open and frank with the media. We respond to all calls, no matter how unfavorable the situation is. And the media in New York has gotten to understand to know that we will respond to it.

Security is a major issue for every state. Maximum security will bring with it maximum costs. I have touched on some of the points as to how you handle your vendors.

On audits. We do a lot of audits. In an eight year period, we have had five external audits by the controller of the state of New York. We have annual audits by Deloitte Haskins & Sells which is a annual financial audit. You recommend that for the state of California. That certainly is a good move. They have also done four management audits and two administrative audits, and I have my own internal auditing unit which has done 133 audits of various aspects of our lottery operation over the past eight years.

Security and audit staff consists of eight people. My security officer has either been a retired policeman, retired F.B.I. or someone with that sort of background.

ASSEMBLYMAN ALATORRE: Now is there anything that you have written as to the background of say the head of security?

MR. QUINN: Yes, I don't have it with me. I have a job description then when we provided it to civil service, we say we

want somebody that has four or five years experience with police departments.

In conclusion, Mr. Chairman, the lottery is a big business. It depends on credibility with the public. Political interference will surely help to destroy it. The lottery job is to earn revenue for the state. It is not to determine who gets the money or how it is divided. I have always managed to stay out of that argument and push it back to the poor legislators and say well, go talk to your legislator. All I do is earn it and make sure I can account for it.

I would be happy, sir at this time to answer any questions you might have.

ASSEMBLYMAN RICHARD FLOYD: Mr. Quinn, first congratulations for a guy that has read, but not studied our initiative. You seem to have a fast grasp.

You purpose of being here, you started off with is to give advice to California. It is obvious that you work directly for Mayor Cuomo in your earlier statements. Is that who you are representing here?

MR. QUINN: Yes, I am work for Governor Cuomo. This trip is being paid for by the National Association of State Lotteries which has in its bylaws to assist new states. When the request was made by the committee to appear...

ASSEMBLYMAN FLOYD: This is no particular interest in that association. It is just an association...

MR. QUINN: The association itself. I cleared, incidentally the visit with the president of the association before coming out here.

ASSEMBLYMAN FLOYD: Just the association.

MR. QUINN: Yes, sir.

ASSEMBLYMAN FLOYD: Nobody that works in your agency in New York has any interest in this thing or anything like that?

MR. QUINN: No, sir. You mean has interest in what happens...

ASSEMBLYMAN FLOYD: You know, we very rarely get somebody who comes out and gives anything unless they have some interest. It is very obvious the people who oppose the lottery are not interested in your coming out and advising us. And, this association just wants to spread lotteries throughout. That's their only interest. Nobody that wants to run a lottery in California has any interest...

ASSEMBLYMAN ALATORRE: Wait. Let me just interrupt. We are the ones that invited him and his trip was paid by the Association...

ASSEMBLYMAN FLOYD: Oh, I don't care who paid. I just want to...

ASSEMBLYMAN ALATORRE: We are the ones who invited him...

ASSEMBLYMAN FLOYD: Who has a greater interest other than us?

MR. QUINN: But let me say, sir, I have appeared in the state of Louisiana, I have appeared down in the state of Florida, was president of the association for two years ending in March. It is not that lotteries, when you say the association, wants to spread lotteries all over. It is not in our bylaws to go out and force lotteries into jurisdictions that don't want them. But any political entity that calls and says we would like some

assistance in getting this set up, we want to help them because if somewhere it goes down, it hurts all of us.

ASSEMBLYMAN FLOYD: I have a card club association in Gardena. If you guys want to start draw poker in New York, call us. We'll send somebody out. We'll give you all the advice you want.

MR. QUINN: You have to see somebody else on that one. I don't handle draw poker.

ASSEMBLYMAN ALATORRE: Are there any other questions?...Mr. Quinn, thank you very much. Mr. Charles Casey and Jeffrey Greybill...Allen, maybe you want to introduce the people.

MR. ALLEN SUMNER: Mr. Chairman and members, I am Allen Sumner from the Attorney General's Office. With me today is Pat Casey who is chief of our bureau of organized crime and criminal intelligence, Nancy Sweet who is a deputy in the criminal division, and Jeff Greybill who is a deputy in the government law section. Collectively I think they can answer most of the questions the committee will raise.

The sergeant just handed out our written response to the questions you sent us back in July. I will just briefly summarize the highlights.

As to security, the initiative itself does not provide the security measures within it. It defers to the commission once appointed to adopt its own regulations. The problem is that the initiative also requires the lottery to be implemented within 135 days which is roughly the end of March. You have no security measures in the initiative. It has to be passed, the commission

appointed by the Governor, and they must promulgate the regulations. The commission members themselves, the director are not designated as peace officers so therefore they would not have access to confidential criminal history records at either the state or the local levels so the commission is not going to be able to do its own internal checks.

It is exempted from the Administrative Procedures Act so that any regulations they promulgate will not necessarily be open to public review and comment. Outside law enforcement agencies don't get to review and comment upon it.

Finally, due to a drafting problem some ambiguity as to what provisions of the existing Penal Code would apply to any abuses. Now all of those problems could be cleaned up with legislation, but it would have to be done on an urgency basis, presumably implemented and given a chance to operate for the 135 days run. That in a nutshell is sort of the highlights of the security problem.

ASSEMBLYMAN ALATORRE: Okay, Next... You are going to tell me that all of you came and you don't have anything else to say?

MR. SUMNER: When you summon, we come in mass.

ASSEMBLYMAN ALATORRE: Maybe you want to comment on video lottery terminals.

MR. SUMNER: I will defer to Nancy Sweet. We touch on that briefly on Page 3 of the written analysis provided to you.

MS. NANCY SWEET: We are aware of the Legislative Counsel's opinion which has concluded that the video lottery terminals would be prohibited by the initiative. The problem is there are

some indications in the initiative that that might not be a real clear conclusion.

The AG does not want to make a formal opinion at this time one way or the other, but has indicated that he would submit, if requested by formal request, would submit the issue to the Opinion Unit with particular direction for them to look at two parts of the initiative.

The first is the proposed Section 8880.28 which refers to computer terminals. Now it seems that would be sort of a useless provision if the video terminals weren't contemplated by the initiative.

Second, the initiative itself attempts to exempt the state lottery from the application of some of the laws prohibiting gambling. It is very express in regard to the lottery laws, Penal Code 319. However, language in 8880.2 is not as express with regard to slot machine or gaming violations. I think those two provisions may get at least arguable that video lotteries may be allowed in California.

My instincts are to go with Legislative Counsel and say that they are right by statutory by construction and various other reasons, but the AG doesn't want to make a formal opinion, but just wants to note that the issues is not very well settled and that could be susceptible to allowing video lotteries. It seems that the Legislative Counsel has done a good job on the construction of all the provisions together, trying to reconcile them all. I can't explain why they make a reference to video lotteries in that one part of the initiative if they don't intend to include it. But...

ASSEMBLYMAN ALATORRE: In other words it's unclear...

MS. SWEET: It's ambiguous. And one of the things that we would be interested in is clearing that up ahead of time if we can by some type of legislation, I think.

ASSEMBLYMAN ALATORRE: What would be some of the legislative remedies that you would seek out? You mentioned, obviously your concern is the security. I am interested in the gentleman who is the head of organized crime. What specific recommendation would you make to the Legislature?

MR. CHARLES CASEY: Well, I think in reference to your question about preventing fraud, corruption and organized crime...In relation to the question you asked it strikes me that the initiative does not spell out the safeguards. It doesn't provide for checks and balances. It really doesn't provide for oversight.

It says that we are going to submit a number of reports to various people, but it really doesn't say what those people are supposed to do with the reports they get. I think that in relation to the rules and regulations and policies that the committee has to establish -- there is no way that we could, I guess were almost precluded from that, Nancy, review those before they are written and tell you whether you are operating in a safe and sane manner. I think another issue which falls into this is the issue that you have in regard to the director, the deputy director, and appropriate staff as to their role regarding their peace officer status as you are perfectly aware. If they don't have that, then they are not entitled to basically any of the

information that they are going to have to rely on from police agencies to determine the background information they are going to want to get on the various vendors and retailers or whatever their rules and regulations end up being.

So that is an essential area that they are going to have to come to grips with.

ASSEMBLYMAN ALATORRE: What other deficiencies do you see?

MR. CASEY: I don't know how deficient it is. I have a question I suppose in the types of background investigations that you might be thinking about or might require. To what depth would be think about going, how far is appropriate to go, how much money do you want to spend on this, and I think you can run the gamut.

It seems to me it would be essential that you know something about your director and your deputy director in terms of their credibility and background. I also think that it is essential that you have some idea of the vendor and the people that are supplying goods and services to the lottery. I notice the initiative refers to anybody with a 5% interest in a business that are being required to disclose in full. I question that as to whether that is appropriate or would 1% be more appropriate. That is just a question of degree.

ASSEMBLYMAN ALATORRE: What is magical about 1 versus 5?

MR. CASEY: Well, I think we found in looking at various business enterprises and operations that you can very often have one person that has 5% of a business, 95 people who have 1% and then that 95 you might find a group of them who are really

undesirable. But you can draw it at any level you want. I think again it depends on how deep you want to go and how concerned you are about the issue, but until the commission makes a decision, it really promulgates a policy of some kind or sets some rules, it is pretty hard to say is that appropriate or isn't it?

Tax returns. I think that is a nice thought to have. I think you have to make a decision again at some point in the game. We haven't had much luck getting tax returns and would that be something that you would want to have as a prerequisite for licensing. You don't submit your tax return, you don't get a license. Or we don't do business with you or we don't approve the contract.

Again those are things that we can't really speak to because they might be provided, but I think that certainly that's something that you might want to consider or the Legislature would want to consider in looking through this in some depth. I think that there are a number of states that have had gone through this process and rather than sit here and try to guess that we did not have time to make a survey of those states to find out exactly what the rules and regulations are or how successful they have been. But I think that would be one thing that should be done. You don't have to reinvent the wheel. Maybe the wheel has already been invented and we could take advantage of that.

MS. SWEET: Can I add something right here? One thing we did do a survey on at least briefly and not every single lottery state. But we surveyed most of them for whether or not their

administrative law process that they use normally for their state agencies applies to the state lotteries. And most of the states that we found, we found that answer to be yes. Now in this initiative, they attempted to exempt themselves from the administrative law process which in effect means that there won't be any process for people to complain or comment upon proposed rules and regulations. That was one thing we noted in our letter. I don't know exactly how to solve that. Did we propose a recommendation on that?

MR. CASEY: We think we pointed that out...

MS. SWEET: We pointed that out. That and the combination of the no definite security provisions for us to look at right now provides a lot of discretion and maybe something to think about if you are trying to provide some type of public input on the rules and regulations of the lottery.

ASSEMBLYMAN ALATORRE: At the present time, there is no relationship between the commission and the Attorney General's Office in terms of either seeking assistance, getting background information and the like?

MR. CASEY: No. That's one thing I should point out that if that was going to occur, there is going to be a tremendous dollar cost to that. It is not a question of getting the dollars from the lottery commission because that money is appropriated. The problem is how do you gear up to the service that account, which as you know in a bureaucracy takes a while to accomplish. It is hiring the people, it's again doing the backgrounds on them, it's

getting the thing just going. So the money is almost irrelevant. Can we get the people? I see that as an impossible drain on our department without some help. I don't think there is any way of doing it.

MR. FLOYD: Thank you Mr. Chairman. Just to flush out the 5% versus the 1% interest -- I think that needs a little clarification. In the regulation of poker clubs in this state, we have a 1%. We took that from Nevada, I believe because we discussed this on and on and on and the reasons thereof. I think that's something that is very important. We are talking about big bucks. One percent of this package is big bucks whereas the little guy with two low ball tables in the back of his joint, we insist on 1% with him in this state.

Further, apparently you don't have the money, you are not going to have the money. Even if you did have the money, what the hell could you do if this thing passed? You have 135 days that we are going to be selling tickets and 30 days in the selection of the commissioners and all. If you had the money, you couldn't run a make and get any real details on anybody in 30 and 165 days the number of outlets. Could you?

MR. CASEY: That would be my opinion. I don't think we could.

MR. FLOYD: Even if we...

MR. CASEY: If you gave us all the money and the people and you hired them instantly to do everything that is supposed to be

done in 135 days so the first ticket could be sold, I don't think could be accomplished.

MR. ALATORRE: How did the other states accomplish that?

MR. CASEY: I have no idea. I don't think they were under that kind of...

MR. FLOYD: Did they have an Attorney General involved in it? Was there some policing other than self policing involved in the other ones?

MR. CASEY: In some cases, from what I understand, and I don't have the thing on all of the states -- In some cases the Attorney General is involved and some cases he is not. In some cases it is a totally autonomous operation. They do whatever they want, basically -- in some cases they don't. But it varies from state to state.

MR. FLOYD: Do you agree with the gentleman from New York that maybe less disclosure might make things work a little better? Disclosure, I understand has to do with skim and a few other interesting things in this kind of a business. Do you agree with him that probably you could run a lot freer and easier without all that room full of paperwork and disclosures?

MR. CASEY: I am certain you could. I am not sure that he meant it in that total regard, but if it was...

MR. FLOYD: If I was running this thing, I would meant it in that total regard.

MR. CASEY: Then I wouldn't agree, no.

MR. FLOYD: Thank you, Mr. Chairman.

MR. ALATORRE: Is there anything else? Okay, thank you very much. Mr. Marguth, Department of Education.

MR. GILBERT MARGUTH: Mr. Chairman and members, my name is Gib Marguth from the Department of Education, Deputy Superintendent for Administration. I am here today to represent Superintendent Bill Honig who apologizes for not being here personally to discuss this issue with you.

We have a position, I suspect that isn't going to win us a whole bunch of friends around the state of California, but it is a position of neutrality. Our reason for that is very simple. We think that over the past two years, the Legislature and Governor of the state of California have acted very responsibly to begin the process of restoring the fiscal base for education in California. The people of California have said through their elected officials that they want to rebuild the educational system. They are willing to pay the price. To that extent, the people of California have increased educational funding in California by some 17% plus in the last two years alone.

What we are looking at here is a lottery that may bring in 2 or 3 percent additional funding for education. If it is not supplanted in some way, and when one looks at the overall magnitude of the problem we have in continuing to move forward towards a solidly financed educational system in California, we are concerned that the voters of California are going to believe

or mistake this lottery as a solution to the fiscal needs of California schools.

Therefore, we think that the issue before the voters ought to be clearly stated as an issue as to whether or not they want a lottery in California. And not whether or not they wish to fund education in California.

Again, we are very concerned that this will come across to the people as a solution to our fiscal needs and when you compare 17% over the past two years to 2 or 3 percent that we will gain from this lottery, it does not even come close to approaching our needs. We have a long ways to go for California to get back to the funding level that it should be at. We want to make certain that the Legislature, the Governor and the people of California keep their focus on those issues.

Second, we are concerned that the question of supplanting is one that can get into a muddying situation. We don't have an opinion as to whether or not supplanting or supplementing is going to be what is accomplished with it. But we are concerned that again there is the opportunity for supplanting and that it is going to be very difficult for us to oppose the Governor and the Legislature and whoever else is involved in the process if we suspect that there is supplanting. So again I think that our energy should be focused on continuing to work with you and with the Governor and with the people of this state to rebuild education and to not get bogged down on an issue as to whether or not we solved our problems through a lottery.

A second issue, and it's one that is more subtle that we are going to be concerning ourselves with in November and that is the Jarvis Initiative. We are concerned that the people of California look at the Jarvis Initiative, listen to our arguments when we say that there is going to be a half billion dollars or more lost of school revenues through the Jarvis one-time windfall tax shift. They will then say that we are going to offset that by a half billion dollars from the lottery. So we will cut our taxes and we will get a windfall from the lottery and that will offset it and there will be no net loss for schools.

Again, we want to be able to separate the issues and let the people of California know that that half a billion dollars is going to come out of our base and that you all and the Governor are going to have to work to restore that if Jarvis IV passes. And that this lottery is not intended to be supplanting money, but supplemental. So the issue gets clouded. The people are going to be looking at this in different ways and we just want to make sure that from the Superintendent's perspective, it is not an issue on education. It is an issue on whether or not the people of California want to have a lottery.

MR. ALATORRE: Have you surveyed any of the other school districts or states that have a lottery as to whether in fact the monies that have been earmarked for education has been in addition to what is appropriated or whether it has been used to supplant monies?

MR. MARGUTH: The answer that we have received and the questions that we have asked of the other states and we have asked most of them to give us information on that. The information we have so far is that there is no clear net gain for education. No net clear gain.

MR. ALATORRE: How so?

MR. MARGUTH: As the representative from New York indicated to you when they passed the lottery, they expected it to be supplemental. But clearly, just one year later, they said okay we were going to put \$5 billion into the base funding for education and \$4.5 is going to come from the General Fund. That is the process that is taking place in most states. This initiative, we recognize, has language in it which says that it shall not be supplanted, that it shall be supplemental. If we had any guarantee that that was absolutely the case, then we might have a little different feeling on this issue.

If we believe that the state and the Legislature and the Governor could treat this the same as they might treat the local bingo game that is used to finance football team or the band uniforms or whatever it might be. We might have a little different perspective, but we don't have any absolute guarantees that it will be supplemental. And again, 2 percent, 3 percent of the funding for education is hard to identify when you have the flexibility that you are looking at here.

We have no consistency over the past decade in California as to school finance, welfare finance, state employees, salaries or anything. Last year we gave 5.9 revenue limit increase for K-12, we gave 10% increase to the state employees. Should we have given 10% to schools? And could we then therefore argue that this was supplanted, if we had the lottery in place?

We think that there are lots of issues involved here that are not educational in nature and that we just hope that when the people vote on this that they do not believe that this is solving the educational needs of the state of California from a financial standpoint. It is a relatively small incremental amount of money that is going to come into education, if it is allowed to be supplemental.

MR. ALATORRE: Now is this the position of the Superintendent or is this the position of the State Board of Education?

MR. MARGUTH: This is the position of the Superintendent.

MR. PARKE TERRY: Mr. Marguth, I have a couple of questions. One of them relates to whether the earmarking of the money for instructional purposes correlates with the educational needs that you have identified in the department. Is that the highest priority at this point? Or is there a justification for using some of those funds for capital outlay purposes?

MR. MARGUTH: We interpret the language to say that the Controller will cut a paycheck, if you would, and send to every school kid in California about \$100, if you look at the language,

each year from the proceeds of the lottery. That money shall be used for instructional purposes within the school. That can be for teacher salary, for textbooks, for normal operating expenses for the base funding for education. We think that that language is fairly clear.

MR. TERRY: Don't you think there is a supplanting problem there also and that the local school district could take money that would have been allocated for instructional purposes and use that money for capital outlay?

MR. MARGUTH: There is that possibility. There is also the possibility as was suggested here for New York state that the state Legislature and the Governor could view this as another source of revenue. We would be opposed to that, obviously, if the language is clear in here. We would be arguing that you ought not to supplant and we would be putting that argument forcefully. But, it is very difficult to identify what is the highest priority and it is very difficult to get down to a question as to whether or not there is a supplanting issue.

MR. TERRY: Is there a way so that local school districts don't use that money to supplant normal funds that would be available for instructional purposes? Could the Department of Education enforce that kind of...

MR. MARGUTH: We don't think that it is a local school district issue. We think it is really a state level issue. There really aren't any funds that local school districts can

supplant. Every dollar they get we send to them, in one form or another. We either tell the counties to cut them a check and send them money or we take it out of the General Fund and send it to them.

MR. TERRY: This money is going to be sent directly to those districts by the State Controller and it is not going to be through the Department of Education.

MR. MARGUTH: That is correct. And so long as that money goes to the schools in the state of California, and we can ignore that in Sacramento, in our budget process, if we can ignore that, and continue to build \$1 billion or \$1.2 or \$1.3 billion each year under the educational base, then it will not be supplanted.

MR. TERRY: Okay, thank you.

MR. ALATORRE: Okay, thank you very much. Ms. Tanner?

MS. TANNER: Mr. Marguth, does the Superintendent or the Board intend to actively oppose the proposition?

MR. MARGUTH: No. As I state, we are neutral on this because we don't believe that it is an educational issue, per se. It is a question of whether the people of California wish to have a lottery. And the Superintendent does not wish to express an opinion as to how he is going to vote on this issue as to whether he wants a lottery or not. He does not believe it impacts the school from the standpoint of educational issues, either from a financial standpoint...

MS. TANNER: Or an ethical or moral issue...

MR. MARGUTH: Ethically and morally, we are all going to have our own consciences to vote on that as will the Superintendent. He has ethical opinions on it. He has moral opinions on it. But his concern is building an educational institution in California and he wants to keep the focus on doing it the way it ought to be done.

MS. TANNER: So if you are concerned about money, possibly supplanting, the money that would be apportioned to education and you don't take any active opposition to the proposition, and if no one else in education actively opposes this proposition very likely would pass. Under the circumstances, don't you feel you have an obligation to take a stand?

MR. MARGUTH: Well, we have a difficult situation. Let's suppose that next year we are able to convince you all to give us \$1.4 billion additional funding for K-12 education. Let's suppose that you look at the initiative and you figure you could give \$400 million from the lottery and \$1 billion from General Funds. We got our \$1.4 billion. We can continue to focus on what we wanted to accomplish in education. We had our funding that we said we needed for that year. So we have a hard time coming back and saying that we are that concerned about the supplanting or the supplementing issue.

But what we are concerned with is that people ought not to lose sight of the need for you to come back and say \$1.4 billion is what we need. You can get the money from where ever you

choose, and if you choose to treat it as a supplemental amount of money, then we may get \$1.8 billion next year. But if we say we need \$1.4 and that is what you give to us, then we can't really complain about it. It isn't a moral issue from our standpoint. If you...

MS. TANNER: Is that called passing the buck or something?
(laughter) inaudible

MR. ALATORRE: It's being neutral. Is there anything else, Gib? Thank you very much. Mr. Babich.

MR. JOHN BABICH: Mr. Chairman, members. John Babich from the Department of General Services and I have some relatively brief remarks I would like to make concerning the contract provisions of the initiative.

I would like to preface my remarks with a comment that under the Fadem Initiative the role that the state control agencies, which would include General Services, has been directly given to the lottery commission, created by the initiative. The power granted the commission extends to all areas that normally are accomplished by the Department of General Services or under the auspices of the Department, which would include procurement, construction, and contracts for services and consultant services. This means that the lottery would not be required to use the professional purchasing services of the Department's Office of Procurement for the purchase of supplies and equipment, including the purchase of such items as simply as vehicles. They would not

be required to use services of the office of the State Architect for construction contracts. They would not be required to use the services of office of space management for the negotiation of leases for office buildings and space. They would not be using the professional services of the office of real estate for the acquisition of real property.

Contracts for services and consultant services would also not be subject to review and approval of the Department of General Services Legal Office which is contrary to the intent of the Legislature expressed as recently as 1982 in companion bills authored by Senator Presley and Assemblywoman Moorhead.

In summary, given the language of the initiative, General Services would not have any interface with the lottery created by the act unless the lottery requested the Department's services on an as needed basis. The Department has no review or approval authority over their proposed awards for goods, services, and construction contracts. The exemption granted the lottery is in contrast to the intent of the California Legislature that state agencies be subject to the use of services of our Department in its role as the state's business management agency, as well as its role as a state control agency.

We have been asked by you to provide a general overview of the state contract review process. Our legal office reviews professional and consulting service contracts for compliance with the selection methods as stated in the contract as well as

reviewing the contract for terms consistent with the best interest of the state. There are various dollar limits involved. Contracts from \$100,000 to \$150,000 must be signed by the Department's chief counsel. Contracts for \$150,000 and above must be directly signed by the Director of General Services. There is also a pre-review process for professional and consulting contracts involving engineering architectural services valued at \$50,000 or more.

The one exception to General Services Legal Office and Director's office review is in the area of professional consulting contracts for EDP services. Review of these has been delegated to the Office of Procurement EDP Acquisition staff. As part of that review, they also review the sole source aspects and determine whether or not limited bidding or no bidding is justified.

We feel that the contract review process has worked to the benefit of the state by insuring the contracts are properly drafted and the state's interests are fully protected. This review process coupled with the requirement that state agencies use state contracts for commodities and submit purchase estimates at the state central purchasing agency minimizes the possibility of graft, fraud, and collusion.

In answer to the question as to whether we believe that competitive bidding should be required for the procurement of lottery goods and whether such contracts for commodities should

be reviewed by a control agency, we can respond that the competitive sealed bid process, coupled with the vendor bid protest system, currently in effect for commodity purchases, insures the lowest possible price and equity in the treatment of vendors. We are not in a position to comment on whether contracts for lottery goods should be subject to the review of a state control agency. Necessity for such review would be dependent on the nature of the contract and whether the lottery personnel involved in the procurement had the expertise to carry out the procurement without the need for assistance or review. It should be noted that under the initiative, the sole contract review process including contracts for goods, services, and construction is to be carried out by the lottery commission.

Other elements the lottery initiative lacks and which are present in the state's centralized procurement system include the maintenance of qualified bidders lists, the public posting of bids, and a formal administrative hearing process through which vendors may have their protests against proposed awards decided. In the socioeconomic area, there is no provision for compliance with the Small Business Procurement and Contract Act, which seeks to increase the participation small minority women-owned businesses in procurement and construction contracts.

The approach in the Fadem Initiative, which sets up an independent lottery commission, is in contrast to the way state lotteries are set up in the states of New Jersey, New York, and

Pennsylvania, and perhaps in other lottery states as well. In those three states, the lottery is treated no differently as any agency, and is required to use the services of the central purchasing agency as well as being subject to review and regulation of the various state control agencies.

This concludes my prepared remarks on the initiative and I would be pleased to respond to any questions.

MS. TANNER: Tell me, would this initiative then not require competitive bidding or limited force account, or prevailing wages? This initiative would set up a state agency of sorts, right?

MR. BABICH: An entity, yes. A commission entity.

MS. TANNER: Yet, it wouldn't have to respond to the laws and requirements that other state entities...

MR. BABICH: That is correct. It would set its own policies and regulations and rules. There is a...

MS. TANNER: There is no oversight by the Administration...

MR. BABICH: There is a paragraph in the initiative that talks in terms of awarding contracts to the most responsible source and takes into account besides price delivery and other aspects of an award which makes it possible to the commission to determine its own criteria for making an award which doesn't necessarily have to be lowest responsible bidder.

MS. TANNER: Of the commission?

MR. BABICH: Yes. No appeal process.

MS. TANNER: Thank you very much.

MR. ALATORRE: But it's also conceivable that the commission could set up rules and regulations that would conform with other state entities. It's possible.

MR. BABICH: Yes. At the initiative of the members.

MR. ALATORRE: So in other words, at the present time, it's silent on that issue. Right now, they have all the powers without any of the responsibilities...

MR. BABICH: That's correct.

MR. ALATORRE: But conceivably the commission could institute the responsibilities like any other state entity.

MR. BABICH: That's correct.

MR. TERRY: Just one quick question. If, the commission as is required, must start a game within 135 days of the voter approval of this measure and if they were required to comply with the normal General Services procedure, is it possible, in your opinion, for lottery sales to begin within that time frame?

MR. BABICH: It think it would be very difficult. I also call your attention to that portion of the initiative that talked in terms of vendor relations and contracts which requires ownership information, background checks and requires performance bonds equivalent to the value of a contract over a period of a year. So those are additional requirements that are placed upon perspective vendors that we normally do not impose. In my judgment that would limit the number of suppliers that would be

interested in doing business and it would also make it a more lengthy process.

MR. ALATORRE: Is it also conceivable that could apply to even the purchase of pencils, paper and the like?

MR. BABICH: Yes, because there is no identification of a minimum or a floor. For example, our sealed bidding starts at \$5,000 so we have administrative flexibility below that figure. And there is no mention in the initiative so it would appear on the face that it applies to all purchases regardless of minor dollar volume.

MR. ALATORRE: Okay. Thank you very much. Mr. Barry Fadem.

MR. BARRY FADEM: I think you just get Mr. Fadem. The first comment that I would like to make while I think any individual in the state of California would be very happy to have an initiative named after them. I am appearing here today on behalf of Californians for Better Education and I brought for the committee today a list of approximately 5,000 individuals and groups who are supporting the efforts of Californians for Better Education. As a courtesy to the members, we have arranged them by county which may make it easier for you to find out who in your district is supportive.

MR. FLOYD: Alphabetical by county, though, right?

MR. FADEM: Correct. Barry Fadem. I would like to start with some opening remarks and obviously enough questions have been raised. I will try to address as many of those as I can. I feel slightly outnumbered today.

One advantage that California has, unlike California in other areas where we have lead the nation, there are 17 other states, as you have heard, who are operating lotteries. And one of the great advantages that we had as we sat down to try to draft what we would hope to be the best lottery law in the country is that we were able to review and discuss with elected officials, directors, lottery personnel and everyone connected with lottery operations in the other 17 states. That was a laborious process, but one of the things we continued to ask was - if you had to do it over again, what changes would you make, how would improve how you started, how would you address these problems?

We've got an opportunity here in California to start with a fresh slate. For example, you heard Mr. Quinn's comment that if he had his "druthers" he would prefer not to even have the commission. We heard that from other states. We also heard from other states that a commission was very important. So we have drawn on an incredible amount of information that has been available from the other states.

One of the gentlemen from the Attorney General's Office made the comment - I guess we don't have to recreate the wheel. I think, in large part, that is a very accurate statement. In learning from the other 17 states, there were two points that virtually every individual connected with the lottery drove home.

First, the need to change the perception of what a lottery operation is like. A lottery is a business. I am not familiar

with any aspect of California state government whose sole purpose is to raise money for the state. As a result, we are talking about establishing an entity that is much closer to a business than to a operating state agency which is rendering services. That had tremendous impact on us in terms of some of the provisions that are in the initiative, simply because to place the lottery commission in an part of the state bureaucracy potentially would cripple the commission and the lottery to do what it is supposed to do --which is to bring in money for the state of California and have that money to go education.

One of the things we had to familiarize ourselves with and in the other states is what changes they made in order to accommodate the need for the lottery to operate as a business -- a money generating entity.

The other point that we learned from the other states is that the need to establish public confidence in the operation of the lottery was very important because of some of the myths that have been perpetrated concerning lotteries for years, most of which have been refuted. The people of the state of California as in the other states want to know that when they play the lottery, it is going to be administered fairly. If they win, they will collect their winnings. If they lose, they know that the money is also going to go for a good purpose. But they want to have confidence in the operation of a lottery.

Those were two very important points that we try to address in the initiative.

A third one which really flowed out of those two is the need for flexibility. I was kind of interested in some of the comments today -- where they were directed and things that are not in the initiative. I have also heard lots of comments from other people as to the length of our initiative. I think if we had tried to cover every single point, for example, that was raised today, and several hundred that have not been raised, we may have ended up with approximately a 50 page document.

What we have tried to do in this initiative based on the experience of the other 17 states establish a workable framework. At the same time, allowing the commission, whose responsibility it will be to administer and supervise the lottery as much flexibility as possible. I think as we go through some of the points that have been raised today...

We have a checks and balances that really has not been discussed. There seems to be some concern over the power of the commission. I would like to remind you that this is a commission that is appointed by the Governor and confirmed by the Senate and it is a commission that will not be operating in a political vacuum. I fully expect that a number of the provisions that some concern has been expressed over today will not result in a problem.

Let me start off by discussing one of the major concerns that I have heard here today which is the ability of the commission to be operating within 135 days. Let me share with you that in 10 states that have instituted a lottery, all have done so within 135 days. That includes promulgating rules and regulations, establishing all of the systems that you heard discussed today. A number of those did it in less than 135 days. It has been done, can be done, and we expect it will be done in California. But, I think a lot of people may be speaking from not good information. It has been done in a majority of the states that have established lotteries.

MR. FLOYD: If you don't mind, I will break in, Mr. Fadem. The 135 days. If I can direct you to Question 13 in the staff report. Wait a minute. I want to go first to the question, I can't find it now -- relating to the direction to instant lottery that some people think that's why the 135 day thing for some reason or other.

MR. FADEM: I think we have a very simple reason why. I am going to discuss our calculations on the number. We are talking about \$2 million a day for education. We looked and spent considerable amount of research time asking the other states and determining what would be the most reasonable period a lottery could operate in California. We think the 135 days is fully meetable and when we are talking about \$2 million a day for public education, the same thing with the 30 day requirement for the Governor.

MR. FLOYD: Yes, that's even probably more important than the 135 days. A question might be asked how can you go about selecting that person at a salary range of \$65,000 limit in 30 days? I guess the cynical person would say, Mr. Fadem, you ought to be very confident that you are going to be in good shape on November 7. Isn't it true that you already have your director lined up and some conditions and isn't it going to be you?

MR. FADEM: I don't intend to apply.

MR. FLOYD: Okay.

MR. FADEM: Let me answer the 30 day question, though. There are two reasons for the 30 day. I think if you asked the Governor's office right now -- I think they would probably be able to tell you that they are already receiving resumes.

You are correct. We are confident that this initiative is going to pass in November and a lot of the questions have been raised. If everyone wants to wait until November 6 to see the vote of the people, they may feel free to do so.

But the 30 day requirement is in there for the same reason the 135 day requirement is. First of all, we think that this may be one of his or her (future governors) most important appointments he will make. You are talking about a tremendous amount of responsibility here. We see no problem. If he is willing to spend the time and we expect that if it passes, he will spend the time. We see no problem...

MR. FLOYD: And you expect to have some input in that also.
You have a candidate.

MR. FADEM: I have no candidate.

MR. FLOYD: You are foolish. (laughter) If I were putting this thing [together], you bet your damn life I'd have my candidate for the thing. But that's all right. You're a little more straight than some of us maybe.

MR. FADEM: Thank you.

MR. ALATORRE: What happens if after 30 days there has not been a selection?

MR. FADEM: Well, I know there are legal remedies available. My answer to that question is that we do not anticipate a problem.

MR. ALATORRE: That's all fine, but what happens?

MR. FADEM: I guess someone could bring a writ to compel the Governor to make that appointment. The same thing with the lottery not operating within the 135 days. But I wanted at least to attempt to correct the notion that it isn't an impossible task.

I would like to comment very quickly on the Legislative Analyst analysis. I will compliment their office. I personally spent upward 4-6 weeks of time talking to the other states, looking at numbers and any number crunching is always subject to interpretation.

For example the Legislative Analyst method of grouping all of the states -- and you heard their calculation. We, in talking to the other lotteries, we feel that California will be much closer in keeping with the western states who are operating. So one of our calculations is based on the per capita sales in Washington and Colorado.

I won't go into the numbers with you, but our projection on the gross only differs - ours is 1.7 - I think the Legislative Analyst is at 1.6. I am not sure I heard him finish. We calculate our projection on 40%. As you heard, is a mandated 34%. We surveyed each of the other states and we have determined that unredeemed tickets amount annually to about 3%, a subject I am going to touch upon in a little bit more detail. Administrative expenses on the average are much closer to 13%.

I think our projections -- if we had wanted, Assemblyman Felando, maybe some of these figures were misleading, we could have chosen the state of Pennsylvania which this year will gross \$1.2 billion. California is twice as big population wise as Pennsylvania and we could have said well it would be \$2.4 billion. I think we are all very much in the same ballpark. I would like to point out that the Legislature in Washington estimated prior to their enactment that the state would generate \$50 million. They generated \$250 million. We actually think that our figures are conservative, but we feel they are supportable.

MR. FLOYD: Based on that, and based on \$1 billion which can be in the middle of everybody's ballpark, I think, Mr. Fadem, would that be a fair assumption?

MR. FADEM: I think that if the Legislative Analyst, would who I think would be conservative, comes in at \$1.6, I am not sure I could agree. That \$1 billion is much too low.

MR. FLOYD: A billion is much too low. But if it were \$1 billion, that's \$160 million for administration every year? That's a nice profit as is \$35 million out of that for marketing.

MR. FADEM: Let's talk about the administrative expenses.

MR. FLOYD: Yes, let's talk about the administrative expenses.

MR. FADEM: When we sat down, there were only two states out of the 17 that have a cap on administrative expenses. We discussed do we put a cap on there or do we ask the state of California, the people, basically give the commission a blank check? Because if you don't put a cap, then whatever happens, just happens. We made...

MR. FLOYD: And on a conservative guess, the cap of a billion, you could have \$160 million. That's not a bad cap.

MR. FADEM: Well, a business that is generating...There are a lot of businesses would like to operate with that administrative...

MR. FLOYD: Including any business, of course.

MR. FADEM: Right. When you say profit, though, these are services that would be rendered to the commission. I think people expect to be paid. We think that's why the figure of 13% we think is much and that is what the other state's figures show. It's much closer to 13%. We had a choice.

MR. FLOYD: So we got 3% for breakage.

MR. FADEM: Three percent for education.

MR. FLOYD: Oh, for education.

MR. FADEM: Because the money that is not used out of the administrative expense pool, every cent of that goes to the public beneficiary, which in this case is public education. So if we put a cap to make sure that expenses do not go higher than that, the people of California were not asked to pass the initiative where the administrative expenses for some reason that we don't know about would go to 20-25-30%.

MR. FLOYD: And as a percentage of the sales go to that thing you would probably come under the \$160 million out of each billion?

MR. FADEM: Yes. Based on a \$1 billion...

MR. FLOYD: \$155 to look good. I have no objection. I'm just...

MR. FADEM: How about \$130?

MR. FLOYD: \$130 -- split the difference.

MR. FADEM: I'll concede that.

MR. FLOYD: I don't believe it, but I think it's fine.

MR. ALATORRE: All right, continue.

MR. FADEM: Yes. I wanted to comment on the numbers.

I guess the other general comment I would like to make is regard to the other exemptions that have been mentioned here.

Again, I'll go back to my earlier point that in talking to the other states, for example, over half of the other states do their own procurement. It was described here as somewhat of an unusual situation. I think that the gentleman from General Services mentioned New York and Pennsylvania. His information is just not current because both New York and Pennsylvania are among the states that have exemptions in the area of procurement.

What is the reason for this -- procurement and some of the other exemptions?

Again, we are not dealing with an ordinary state bureaucracy, state agency. We are dealing with a business. We would fully expect that the commission, in enacting its rules and regulations, will be subject to public scrutiny from Day One -- through the media, through oversight by the Legislature, oversight by the Governor who appoints the commissioners, and we would expect that their rules and regulations may in most cases closely resemble or reflect existing state law. But in drafting this initiative, what we wanted to prevent was to put locks on the ability of the commission to exercise flexibility and make those decisions to lock in, for example, the lottery commission into the state procurement system.

When you are dealing with lottery games, some of the lottery games may last three months or six months. The process of letting contracts and moving that process along we were told by the other states that there was one comment that was given by virtually every state is do not, do not immerse the lottery commission in the regular state bureaucracy.

I will point out that there is absolutely nothing in this initiative that prevents the commission from adopting rules and regulations that mirror existing state law. All we wanted to do was to allow the flexibility.

The question came up on bidding. I will refer you to .60 instead of giving you the first numbers. Under contracts, the awarding contracts in response to solicitations for proposals, the director shall award such contracts to the responsible suppliers submitting the lowest and best proposal which maximizes the benefit to the state in relation to the cost in the areas of security, competence, experience, timely performance and maximization of net revenues.

Let me give you an example. The state of Washington just recently let a contract about four weeks ago. They have developed a very comprehensive, somewhat complicated to the layman like myself, of evaluating lottery proposals. There is a lot more that goes into a lottery than just what they will charge for a particular item. It will be a bid process. The commission will adopt rules and regulations that will be made to everyone.

I think the concern about the commission being outside of the bureaucracy should be countered by the knowledge that they will be operating fully in the public.

MR. TERRY: Just along the lines you were just discussing -- one of the provisions of part of the disclosure section appears to me requires that any bid or proposal as part of a procurement contract for any goods or services by the state lottery must include all of these extensive disclosures.

MR. FADEM: The chairman earlier asked the question would this cover if you wanted to order 20 pencils. The way the initiative is drafted, I would have to answer yes. But I would also answer that the commission in promulgating rules and regulations would also have the ability, I think to require contracts under a certain dollar figure. I think there is sufficient flexibility for that kind of situation.

MR. TERRY: Of course it helps not to have to go through the Office of Administrative Law -- if you are going to adopt a regulation that might be contrary to statute.

MR. FADEM: Since you raised it I am not sure I heard it raised it before. Again, that exemption is contained in law. I noted with interest an article in the Sacramento Bee or Union yesterday on the rules and regulations regarding toxic wastes. I think the headline was "Battle over Regs".

One of the things that I think Mr. Quinn talked about -- we're trying if at all possible not to insulate the commission

and the operation of its business from those type of political situations which will rise in any operation. But that exemption is contained for the very reason I have cited before, which is the business. The need to operate a business.

I would like to comment on...

ASSEMBLYMAN ALATORRE: In other words, everything that you have done is under the guise of "it's a business".

MR. FADEM: I don't think I would phrase it that way.

ASSEMBLYMAN ALATORRE: Well, so far everything that you have said whether its contracting, whether its competitive bidding, whether its open meetings and the like, your response has been the reason being is that it's a business. It's unlike any other state bureaucracy.

MR. FADEM: The commission is subject to the Open Meeting Act. Any exclusions contained in the initiative are based on our input from the other 17 states who have been operating lotteries. You must view the operation of the lottery in a business context. Now this doesn't mean you give the commission the right to do anything they want with absolutely no reviews.

I will comment on the number of reports and information that will be presented. They are going to be in a fishbowl. I think any gains can be played by commission, first of all is appointed by the Governor and confirmed by the Senate. That is not a concern that we share. You will hear between now and November the term "squeaky clean". One of the comments that we have

gotten from some of the other states is, "Boy, that's a tough law."

You have forced disclosure, other states are moving in that direction, but the provisions that we have in here to protect the integrity of the lottery we think will withstand scrutiny.

I would like to comment on some of the Attorney General's Office concern about the lack of specific regulations in here concerning security. I would like to point out that I think we are the only state that will have this provision. That is why we have provided for a deputy director for security in Section .38 who is directed to confer with the Attorney General to insure integrity, security, honesty and fairness in the operation and the administration of the lottery.

The other thing I will tell you is that I would be more than happy to provide the Attorney General's Office...I have read every state law and I have read all the rules and regulations. I would be more than happy to give them a synopsis of rules and regulations as adopted by the other states.

We don't have to recreate the wheel and I think the number of provisions we have here concerning security and reporting of exactly what is going on in the commission -- the independent audits -- I think they will be pleased with the results.

One other issue that has been brought up. There have been a number of other issues, but let me comment on the video lottery. That seems to have caused some concern. Let me tell you what the

intent of the initiative was and is. We wanted to give the commission maximum flexibility to select any and all games that they deemed to be in public interest and that they would like to operate.

For example, we don't know what type of lottery games may be developed in the future. We had no desires to tie the hands of the commission to any specific game. I will reference you to sections in the initiative that does that. What I would like to quickly do is just read you one sentence that is contained in the ballot argument that will be in the Voter Pamphlet which will be obviously going to every registered voter:

..."The lottery commission has the flexibility to conduct a variety of lottery games using any technology, including traditional tickets, on-line computers, and instant game video terminals (which can't dispense cash or have fruit symbols like a slot machine)..."

That is the intent of the initiative and I must object to the Legislative Counsel opinion because the rule of statutory construction relied upon in that case, while I agree upon the rule of statutory construction, is implied improperly and we could spend quite a bit of time arguing on that.

Let me just direct your attention to three provisions as the AG's Office noted that it wouldn't make very much sense to have a sentence as contained in .28c which makes a specific reference to "shall be dispensed to players from such computer terminals or

devices." We also in .2 establish a general exception "except for the state operated lotteries established by this chapter." Lastly, a section which no one seems to either have read or paid much attention to -- I will direct your attention to .70 Lawful Activity:

"Any other state or local law providing any penalty, disability, restriction, or prohibition for the possession, manufacture, transportation, distribution, advertising, or sale of any lottery tickets or shares shall not apply to the tickets or shares of the California State Lottery."

The other comment I would make on the video lottery issue is that Legislative Counsel looked at Section .6. Those Penal Code Sections 320 (the ones that are included there) all apply specifically to penal matters affecting lottery. We group those all into one section and then in the other areas that I have pointed to you clearly cover the ability of the video lottery to be permitted. So if there is any question after today, at least as to what the intent of this initiative clearly contemplates giving the commission complete flexibility to choose any and all games based on their review.

For example, I am aware now that the state of Illinois is the first state that is currently testing video lotteries and whether or not that will be successful or not -- we don't know. Video lotteries may not even be an issue in three years where there may be types of lottery games that are developed. Again, our intent

was to give the maximum flexibility to the commission to make that decision.

I think that concludes my general comments. I don't know if I have responded to the number of questions raised. I tried to cover as many as many as possible, but I would be more than happy to answer any other specific ones.

MR. ALATORRE: No. I think obviously the concern that has been raised has been about contracting. You say that you are open to the Open Meeting Act. The question that your regulations are not subject to OAL review -- those are some of the issues that obviously are of concern to this committee. Any other questions?

MR. FLOYD: I would like to add a couple of things. In the first place, Mr. Fadem, you are to be congratulated for putting something on the ballot this Legislature should have done some time ago. In my own view maybe we would have done it differently. I oppose the measure only because I think it's a phony thing on the education thing. I don't like the earmarking. But I can guarantee you that on March 22, I will be one of the suckers buying tickets. And before you leave, I would like to talk to you about, in a related matter, down the line. I am a pro-gambling man on this committee and you look like a winner to me.

MR. FADEM: Let me ask you this -- are you putting your hat into the ring to become...(laughter)

MR. FLOYD: It's a hell of a pay increase for me. (laughter)

MR. FADEM: Thank you very much.

MR. ALATORRE: Okay, Nancy Jenkins.

MS. NANCY JENKINS: Mr. Chairman, committee, my name is Nancy Jenkins. I am representing the California State PTA. Apologies from Grace Foster who was to be here and could not make her commitment and asked me to serve.

I am the education advocate, a volunteer for PTA representing their viewpoint from Sacramento on various educational issues.

We feel this is definitely an education issue the way the initiative is written. Anything that impacts upon education or the state's fiscal well-being, we have definite obligations to be concerned with how it turns out and how it is written.

We would question as has been done many times here before today, Section 8880.1 because that is where the intent language is and we question if the intent language -- to not supplant the monies going from this fund to education -- is really going to hold up under operation. Will it, in fact, end up as perhaps has happened with the Riley Act of many years ago where sales taxes were looked at as perhaps funding education and obviously have been put into the General Fund of the state in order to fund the services that the state does fund through its mechanism?

We were interested in listening to the language that people have been speculating on. That is a grave concern to us. We also feel there is some serious problems regarding the use of the

resources by the school districts themselves. At first glance we felt that the wording in the initiative was very good. It said they must be used exclusively for the education of pupils, but then if you read further it says no funds may be used for the acquisition of real property or construction of facilities. This negates the local districts ability to answer one of the most distressing and pressing needs that this Legislature has been unable to answer because of the tremendous fiscal commitment that it would take and that is the construction of new facilities as well as renovation of unsafe facilities that are perhaps even lacking in earthquake prevention or earthquake proof.

So we feel that it is ironic that on the same ballot we will have a state capital bond outlay initiative and we fear that if the voters think they are taking care of education with the lottery initiative, that we chance having the bond initiative voted down. Therefore we are back to Square One with over crowded classrooms and unsafe facilities that is prevalent throughout the state, let alone the deferred maintenance problems.

We also hope desperately that the funds, as they are used by local school districts for the instructional purposes because they are going to be subject to collective bargaining, will not be used to a degree that if something happens to cause the monies in from the lottery to fluctuate. Or heaven forbid if California, first getting the lottery off the ground, should end

up with a New York type problem where the Legislature and the Governor had to say the lottery could not be in effect -- a concern that districts may have obligated themselves with monies that would not be coming through then each year and they would be giving not one-time expenditures of these funds, but on-going expenditures in the way of salary and fringe benefits.

I don't know that there is anything that you could do to address this, but it is a concern to us that the monies that do come to schools be looked at with a great deal of discretion in the first years if this does pass. There may be tremendous fluctuations.

We also think it's going to be unique to find school districts -- the state promoting gambling because they have committed resources to on-going commitments such as the salary and fringe benefits under contract. What would be the answer if the fluctuation became too great, or if you did have a problem and had to curtail the lottery until any problems could be worked out?

We find that there are some other problems that we would like to see addressed that are down the line. Particularly, if you look at placement of these lottery games and particularly as we learn that most often they may become, as time goes on, the attractive video game type of lottery. Most of these games will be placed in convenient shopping centers, your small drug stores, liquor stores, mom and pop grocery stores. Supervision is often

very difficult for the owner of a small store. There may be only one person on duty at a time. We have already experienced in PTA severe problems with our concern in the amount of time and money that the young people spend playing the video games. This is going to require that closer supervision be given because the young person could be playing the video lottery game, not be 18. We also know how the system works among young people where if they want to obtain something that they are not of age to obtain, there are many friends and many ways that they can go about to do this.

We feel this is going to entail perhaps more local involvement of the police force or the sheriffs in the community -- perhaps more scrutiny given to where the games are placed because this will the impact on the activities of young people. We feel that there will be an attractive nuisance value in the fact that the places may have sums of money on hand if they are the instant pay kind of game that is utilized. Therefore that will also impact on the needs of local law enforcement.

Finally, we would like to say that we are concerned that the commission itself do a great deal of screening. We have heard this discussed by several people here today. We can only add our concerns that whoever does come into this state, whoever does get the contracts to run the lottery, would be so reputable that the funds for education consists of what is being used to convince people that they should vote for this would not be cut off

because something drastic has happened to the whole lottery game system or that there were any chance of the funds being curtailed in any way.

Obviously, our gravest concern is the fact that it is a \$12 billion business for K-12 education only. If you include all of the other levels of education that this Legislature has been funding, it is a tremendous amount of money even above that.

We are concerned that the people, Legislature, the Governor who have finally come to recognizing that they have a unique system in this state since Prop. 13. That the State Legislature does indeed fund 90% or 95% of education.

We'll be diluted into thinking that the lottery solved the problem of the on-going stable funding sources we most desperately need to have for education. That is the real basis for our concern. If you have questions, I will try to answer them. We appreciate your time.

MR. ALATORRE: You're quite welcome. Thank you very much. The last witness is Mr. Trevor Thatcher.

MR. TREVOR THATCHER: Mr. Chairman, members of the committee, my name is Trevor Thatcher. I am the director of the Games Management, Inc. and the director of the Vernons Organization in Liverpool, UK. I am accompanied by Mr. Edwin Copley.

Mr. Chairman, let me start with my company's credentials. Games Management, Inc. is a New York based company associated with the Vernons Organization of Liverpool in the United Kingdom

which has promoted and operated sports pools and lotteries for nearly 60 years.

Vernons have operated more than 100 lotteries in the United Kingdom for local authorities, charities and sporting organizations. In the last 10 years we have set up soccer sports pools and lotto in Australia of which we continue to be responsible under conditions similar to full facilities management arrangements.

In 1978, Games Management, won a full facilities management contract with the New York State Lottery for the marketing and operation of lotto, the first successful lotto game in the United States.

The penalty for being last to speak is that usually the subject has been well covered by previous speakers. I intend to summarize the written testimony that we have submitted to the committee.

The first point I would like to make is that we firmly believe that the lottery initiative has greatly benefitted from the vast amount of publicity which is being generated by the huge lotto prizes paid to lotto winners.

Lotto is the fastest growing lotto game played in the United States today. Californians will wish that their lottery to be just as good as any played elsewhere. And we believe in their minds the public will be voting for lotto in November.

To be successful, it is important to give the public what they want. We have concerned ourselves mostly with the question of revenues which the lottery will generate. With regard to this, we had to assume what form the lottery will take, what types of games will be played. However, we believe that the only practicable game to start with to an early date and in the short time available is an instant game to be followed within 12 months by the introduction of a lotto game.

In our assessment to revenue potential, we assume this will be the case. We have taken into account the experience of recently introduced instant games and lotto games in the United States. Here I make the same point as the first speaker. Instant games generally start up with extremely high sales levels, but soon show declining sales patterns, eventually finding a lower level, but still filling a substantial niche in the lottery games mix.

Other states have been more successful than Arizona, but based on the first year in Arizona with instant ticket games, California could expect more than \$1 billion to be generated in first year sales. This could prove to be a very cautious estimate when we look at Colorado sales of \$72 per capita in the first full year. However, as I indicated earlier, sales of instant tickets show a declining pattern after the initial surge of interest.

Arizona sales were down by 36% from the first year to the second year. This pattern is typical throughout the world wherever instant games are being introduced and played. It has happened not only in the United States, but in Australia and in the United Kingdom. If this pattern is followed in California, sales of instant ticket games would likely to be down to \$700 million in the second year and \$600 million in the third year -- still quite substantial figures.

A previous speaker doubted that lottery revenues can be maintained. We believe it can. Evidence from around the world indicates that a strong marketing approach and the introduction of new games can not only sustain sales, but improve them over a period of time. I have made the case for instant games, but there is overwhelming evidence not only in the United States, but worldwide, that the game generally known as lotto has the potential to be the biggest lottery revenue earner.

With its big regular weekly prizes and the occasional huge jackpot lotto captures the lotto players imagination, attracts worldwide media interest, and creates conditions for continued growth.

We do, therefore, strongly recommend that a weekly lotto game be introduced as soon as practicable -- say after 12 months -- with a second mid-week drawing after a further 12 month period. We have based our estimate for lotto on this assumption.

What does this mean for public education? To calculate for that purpose, we have assumed that 12% -- and it could be much less -- will be the maximum necessary to cover agent's commissions, contractors fees, and administrative costs. If 50% is allocated for prizes, net revenues will be 38% of sales.

We gave no regard to unclaimed or unpaid prizes. On this basis, first year sales could generate \$418 million in revenue, \$456 million in the second year, and \$608 million in the third year.

Setting up and implementing a lottery from scratch is never a simple matter. In a state the size of California, it will be a major undertaking, especially if it is to get off to a good start.

In the proposed act, there is a requirement to start sales not later than 135 days after the effective date of the proposed act. It is the commission's responsibility to determine which type of lottery will be introduced.

It would take some time for the administration to be settled in and the additional time to issue invitations to bid, receive responses to those invitations, and process them so that contracts may be awarded for services required by the lottery. There could be very little time left even to start an instant lottery, which for instance would require the selection, recruitment and training of up to 8,000 agents to give wide access to the playing public across the state.

The proposed act also specifies that as close to 3½% of projected sales as practicable should be spent on marketing for the first year or so. We believe that sales in California will be in the region of \$1 billion, which would give \$35 million to be spent on marketing. Our experience indicates this to be too great a figure. In our written testimony, we have suggested a form of words which may be more appropriate.

In our written testimony, we identify several other areas where the language of the initiative is unclear or where minor changes would benefit the lottery which I don't propose to make now except for one.

Here I would like to refer to the concern for security. We believe that any lottery should have the protection of legislation against players claiming to have winning tickets where the tickets are not winners in accordance with the lottery rules.

The proposed act does not have specific provisions insulating the state and others connected with the operation of the lottery from claims brought by disappointed or fraudulent players. We have suggested wording which could very well be added to the proposed act.

I would like thank the committee for inviting me to be here today and hope our testimony has been helpful and it will go some way towards answering some of the questions that have been asked.

MR. ALATORRE: Thank you very much Mr. Thatcher. Yes.

MR. FLOYD: I just have a couple of questions based on...if you have the analysis that our staff has prepared and a list of questions. If I can direct you to Question 16 under Lottery Game Retailers. The first part of the question is not yours, but with an organization having such wide background, the question on the statutory population outlet ratio on the oversaturation situation -- I think that question comes from the same source that we have on oversaturation of retail liquor stores and stuff like that in some of our communities. Do you have some sort of ballpark situation on that?

MR. THATCHER: Our experience shows that identity of agents to population is in the region of 1 sales agent per 3,000 head of population -- to give the necessary access and availability to lottery sales. We would recommend the number of agents to be of that order for instant ticket games. I wouldn't recommend that it is necessary for the statutory requirements to be in place, but the commissioners themselves would exercise controls.

MR. FLOYD: I guess you covered the only other question I had and that is the stability -- as long as we are funding an educational purpose here. But in continuing, you mentioned that unless there are new games and this type of thing, as I understood it, you think that figure will not be stable through a period of time, or it needs this type of thing to maintain its stability.

MR. THATCHER: Yes. Lotteries do need maintenance. But the experience around the world is that they can be a reliable fund provider. It does require maintenance, change of games where, for example the instant lottery games that we mentioned earlier do provide very large sales initially. We recommended the introduction of lotto because we find that lotto is a game that provides for continuing and improving sales, usually more than by the level of inflation.

MR. FLOYD: That's all I have.

MR. ALATORRE: Okay, Thank you very much Mr. Thatcher. This concludes the hearing of the Governmental Organization Committee. I want to thank everybody that came here to testify. This is going to be before the voters of the state of California in November and which ever way -- the voters ultimately vote either aye or against the measure. I am sure that there are going to be many questions that are going to remain unsolved.

I thank you very much for attending the hearing.

APPENDIX

THE FADEM LOTTERY INITIATIVE

Analysis & Comments

Prepared by the Staff of the
Assembly Committee on Governmental Organization

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August 1984

INTRODUCTION

The Fadem Lottery Initiative, Proposition 37 on the November ballot, proposes to establish a state operated lottery in California with net revenues allocated to public education.

This analysis, prepared by the committee staff, examines the initiative in detail. Particular attention is paid to how the proposed lottery would operate, the kinds of lottery games that would be permitted, security safeguards, and the way moneys raised would be allocated to educational institutions in the state. Staff has also attempted to identify any potential drafting deficiencies and to raise technical problems which the Legislature may wish to correct in "trailer" legislation if the initiative is approved by the voters.

Intentionally omitted from this analysis is any discussion of the social consequences of lotteries, a subject which has been addressed amply, if inconclusively, in other studies.

WHAT THE INITIATIVE DOES

The Fadem Lottery Initiative proposes to amend the State Constitution to authorize establishment of a California State Lottery and to add extensive new statutory law setting forth the details of how the lottery would be operated and how revenues would be distributed.

Constitutional Amendment

The constitutional amendment adds two new provisions to Section 19 of Article IV, which currently contains a general prohibition against the Legislature authorizing lotteries of any kind.

A new subdivision (d) is added which would authorize the establishment of a "California State Lottery."

A new subdivision (e) is added to prohibit the Legislature from authorizing, and requiring the Legislature to prohibit, casinos of the type currently operating in Nevada and New Jersey.

SEC 19. (a) The Legislature has no power to authorize lotteries and shall prohibit the sale of lottery tickets in the State.

(b) The Legislature may provide for the regulation of horse races and horse race meetings and wagering on the results.

(c) Notwithstanding subdivision (a) the Legislature by statute may authorize cities and counties to provide for bingo games, but only for charitable purposes.

(d) Notwithstanding subdivision (a), there is authorized the establishment of a California State Lottery.

(e) The Legislature has no power to authorize, and shall prohibit casinos of the type currently operating in Nevada and New Jersey.

Statutory Provisions

The statutory portion of the initiative adds a new Chapter 12.5 (commencing with Section 8880) to the Government Code, to be known and cited as the "California State Lottery Act of 1984." The act is detailed and provides, among other things, for the creation of a California State Lottery Commission and the allocation of net revenues from the sale of lottery tickets to instructional programs in grades K-12, community colleges, the California State University and Colleges, and the University of California.

Purpose and Intent. The purpose of the act is to provide additional monies to benefit education without the imposition of additional or increased taxes. It is further intended that lottery revenues supplement the total amount of money allocated for public education in California. (§8880.1).

Nothing in the act is intended to repeal or modify existing laws prohibiting other forms of gambling (§8880.2) and no state funds, except for a temporary start-up loan, are to be expended by the Commission (§8880.3).

Allocation of Revenues. The act requires that 50 percent of the total annual revenues of the lottery shall be paid as prizes and that not less than 34 percent of the total revenues shall be allocated to benefit public education. Not more than 16 percent of the total revenues may be used for overhead expenses. (§8880.4).

The State Controller would be required to periodically distribute net revenues from the sale of lottery tickets for public education, as follows, in equal per capita amounts:

- (a) To school districts serving grades K-12, allocated on the basis of average daily attendance.
- (b) To community college districts, allocated on the basis of average daily attendance.
- (c) To the Board of Trustees of the California State University and Colleges, allocated on the basis of equivalent full-time enrollment.
- (d) To the Regents of the University of California, allocated on the basis of equivalent full-time enrollment. (§8880.5).

The act further expresses the intent that lottery revenues be used exclusively for instructional purposes (§8880.5).

Exemption from Anti-lottery Statutes. The California State Lottery would be exempt from anti-lottery statutes contained in the Penal Code which, in brief, make it a misdemeanor to (a) contrive, prepare, or conduct a lottery drawing; (b) sell lottery tickets or shares; (c) aid or assist in the conduct of a lottery; (d) maintain a lottery office or advertise a lottery; (e) insure lottery tickets; or (f) let or permit the use of any building or vessel for the conduct of a lottery. (§8880.6).

Legislative Counsel has indicated, however, that the initiative would not exempt the lottery from other sections of the Penal Code regulating gaming, including Section 330b which among other things, prohibits the possession or operation of slot machines and other similar devices that dispense money or prizes after the deposit of a coin on the basis of random chance. Consequently, Legislative Counsel is of the opinion that video lottery terminals (VLT's) would not be allowed. (See Appendix B).

Lottery Commission. The act establishes a new independent agency, the California State Lottery Commission, which would be responsible for operating and administering the lottery. (§8880.24).

The Commission would be composed of five members appointed by the Governor with the advice and consent of the Senate. No more than three could be members of the same political party. All initial members are to be appointed within 30 days of the effective date of the act (December 6, 1984). The Commission would select its chair from among its membership. (§8880.16).

Commission members would serve five year staggered terms, however, the Governor would be permitted to remove any commissioner, apparently without cause, upon notice to the Commission and the Secretary of State. (§8880.16).

At least one of the commissioners would be required to have at least five years of law enforcement experience, and at least one must be a certified public accountant. (§8880.17).

Legislative Counsel has indicated that officials and employees of the proposed Commission would be subject to the conflict of interest provisions of the Political Reform Act of 1974. Counsel has also indicated that a Commission member could not hold a financial interest in a lottery game retailer or a lottery game supplier.

Commissioners would be compensated at the rate of \$100 per day and reimbursed for travel and other expenses incurred on commission business. (§8880.18).

A quorum of the Commission would consist of a majority of the members appointed and official actions could be taken by a majority vote of those present. (§8880.21). Meetings must be open and public in accordance with the Bagley-Keene Open Meeting

Act, except that the chairman could convene a "special meeting" with 48 hours notice. (§8880.19 and §8880.20).

Legislative Counsel has indicated that the Commission would be required to comply with all the provisions of the Bagley-Keene Open Meeting Act, including the 10-day notice requirement. Counsel also indicated that the Commission would be required to comply with the California Public Records Act.

The Commission would be required to begin sales of lottery tickets within 135 days of the effective date of the act (March 21, 1985) and would be required to establish by regulation the following policies:

(a) The types of lottery games to be conducted, except that no game could use the theme of bingo, roulette, dice, baccarat, blackjack, Lucky 7's, draw poker, slot machines, dog racing, or horse racing. (§8880.28).

(b) The number and value of prizes for winning tickets, except that the odds of winning must be disclosed to the public. (§8880.29).

(c) The method of determining winners, except that no lottery game could be based on the results of a horse race. (§8880.30).

(d) The retail sales price for lottery tickets or shares, except that the price must be at least \$1. (§8880.31).

(e) A system of verifying the validity of prizes and to effect payment of prizes, except that all prizes must be claimed within 180 days and no prize may be paid to a minor or to a member or employee of the Commission, or any spouse, child, brother, sister, or parent of such person. (§8880.32).

(f) A system of distributing tickets to the public. (§8880.33).

Lottery Director. The Governor, with the advice and consent of the Senate, would be required to appoint a lottery director within 30 days of the effective date of the act (December 6, 1984). (§8880.23).

The director would be responsible for the day-to-day management of the lottery and would be paid an annual salary of \$65,000 plus cost-of-living increases effective after July 1,

1984. (§8880.34). (NOTE: The code reference in the initiative is to a repealed statute which has been superseded by Section 11153 of the Government Code.).

The director would be authorized to appoint up to four deputy directors, one of whom would be responsible for security. These deputies would be "civil executive officers", a term which is not used in state government, but is presumed to refer to persons who are exempt from civil service. (§8880.37).

Legislative Counsel has indicated that the four deputy directors would be included within state civil service. However, Counsel states that the director of the Commission would be authorized to select one, who could be one of the four deputy directors, to be exempt from civil service. The Commission could establish the salaries for the deputy directors, but the compensation would be subject to the approval of the Department of Personnel Administration.

In addition to general administrative and management duties, the director would be required to do the following:

- (a) Make on-going recommendations to the Commission, the Governor, and the Legislature on matters concerning the secure and efficient operation and administration of the lottery. (§8880.40).
- (b) Make a monthly financial report to the Commission, the Governor, the Attorney General, the State Controller, the State Treasurer, and the Legislature. (§8880.42).
- (c) Engage an independent firm of certified public accountants to conduct an annual audit of the lottery. (§8880.43).
- (d) Engage after six months and periodically thereafter an independent firm to conduct demographic analyses of lottery game players. (§8880.44).
- (e) Engage after the first year of operations and periodically thereafter an independent firm to analyze the advertising, promotion, public relations and other communications activities of the lottery. (§8880.45).
- (f) Engage after nine months and biannually thereafter an independent firm to analyze security procedures of the lottery. (§8880.46).

Lottery Game Retailers. Lottery game retailers, i.e. persons authorized to sell lottery tickets to the public, would be selected by the director, subject to certain restrictions contained in the Act and to regulations that may be adopted by the Commission. No person under the age of 18 could sell lottery tickets and no person could be engaged exclusively in the business of selling lottery tickets. (§8880.48).

Lottery game retailers would be compensated at the minimum rate of 5 percent of the retail sales price of the ticket, plus incentive bonuses. (§8880.51).

Lottery game retailers would be required to establish procedures to prevent selling lottery tickets to minors, including safeguards to assure that tickets offered from vending machines are not sold to minors. (§8880.52).

Lottery Suppliers. The Commission would be prohibited from contracting with any private party for the operation and administration of the lottery, but would be permitted to contract for game design, supply, advertising, and public relations. (§8880.56).

Any person or business entity proposing to contract with the Commission for goods or services would be required to make extensive background disclosures, including the identity of all corporate officers and directors and all persons who beneficially own 5 percent or more of the corporation's stock. In addition, persons or entities contracting for printing of tickets, goods or services used to record number selections, or goods or services used to determine winners, would be required to submit income tax returns for the past 3 years and a current individual financial statement from each person having a beneficial ownership interest of 5 percent or more. (§8880.57).

The director would be authorized to enter into contracts directly or solicit proposals. All contracts entered into by the director would be subject to the approval of the Commission. (§8880.60).

State Lottery Fund. The act creates a special fund, the "State Lottery Fund", which would receive all proceeds from ticket sales and which would be continuously appropriated for the following purposes:

- (a) Payment of prizes to holders of valid lottery tickets.
- (b) Expenses of the Commission.
- (c) Repayment of funds advanced for initial start-up costs.
- (d) Transfers to public education. (§8880.62).

Additionally, the fund would be available to reimburse other governmental entities for any and all services necessary to effectuate the lottery. (§8880.66).

Exemption from Sales and Income Tax. The act provides that no state or local tax shall be imposed on the sale of lottery tickets or any prize awarded by the lottery. (\$8880.68).

Local Preemption. Cities, counties, and cities and counties would be prohibited from regulating any aspect of the conduct of the California State Lottery. (\$8880.69).

Appointment-Employment Restriction. No person could be appointed as a commissioner or serve as an officer or employee of the Commission who had been convicted of a felony or any gambling-related offense. (\$8880.71).

General Fund Appropriation. The act appropriates from the General Fund the sum of \$16.5 million as a temporary line of credit to cover start-up expenses. This sum must be repaid within 12 months plus interest at the annual rate of 10 percent. (SEC. 4).

Amendment By Legislature. The act prohibits amendment except to further its purpose and any amendment must be by bill passed by two-thirds vote of the Legislature and signed by the Governor. (SEC. 5).

Severability Clause. Invalidity of any one provision would not effect the entire act.

STAFF COMMENTS

Constitutional Amendment

1. Previous legislative lottery proposals have included mandates within the State Constitution that the lottery be "state operated" and that revenues be earmarked for a particular purpose. However, the Fadem Initiative incorporates these provisions in statute, allowing the potential for the Legislature, by two-thirds vote, to permit a private lottery or to shift the use of revenues to a purpose other than public education. Should this be of concern?

2. Fadem requires the Legislature to ban casinos of the type operating in Nevada and New Jersey. Does this imply that casinos of other types -- say those operating in London or Monte Carlo would be permitted?

Educational Allocation

3. How does the allocation of funds for education relate to needs?

4. Fadem restricts the use of lottery funds to "instructional" programs as opposed to capital outlay. Does this reflect actual needs? How can this be enforced?

5. Fadem states the intent that lottery funds supplement existing levels of educational funding. How can this be enforced?

Lottery Commission

6. Lottery Commissioners serve 5-year terms, but can be removed by the Governor without cause. Do commissioners serve term or pleasure appointments?

7. The initiative has an unusual quorum requirement which would permit as few as 2 commissioners to take official actions, including approval of contracts. (§8880.21) Is this desirable?

8. The chair of the Commission could convene "special meetings" without public notice. (§8880.19.). What is the purpose of the "special meeting" provision?

9. Why should the commission's regulations be exempt from OAL review? (§8880.26). Note that they even exempt themselves from the public notice requirements. Is this desirable?

10. What game formats could the commission approve? In particular, are video lottery terminals (VLT's) permitted? Is the initiative biased toward the "instant" ticket game, as some critics allege?

11. Why can't prizes be paid to minors? (§8880.32(i)). What is wrong with an adult purchasing a lottery ticket for a minor as a gift?

12. What is the practical effect of requiring that sales begin within 135 days? (§8880.25). Can sales begin in all parts of the state by this deadline?

Lottery Director

13. How can any reasonable search for a director be conducted within 30 days? (§8880.23). Is the \$65,000 salary competitive with other states? (See Appendix A).

14. Should the executive director be appointed by the Governor or by the commission?

15. What is a "civil executive officer"? (§8880.37).

Lottery Game Retailers

16. How many retailers would be approved in California? Should there be some statutory population/outlet ratio to prevent over-saturation?

17. Shouldn't some background check be made on retailers? Should the commission be prohibited from approving a retailer who has been convicted of a felony or gambling-related offense?

Lottery Suppliers

18. Do extensive disclosure and bonding requirements (§8880.57 & §8880.59) discriminate against small businesses, particularly those run by women and minorities?

19. Is it intended that the contracting provisions (§8880.60) supersede the regular contracting procedure under the State Contract Act? If so, why was this deemed necessary?

20. Must lottery supply contracts be bid competitively? If not, why not?

Fiscal Issues

21. Why is there such a discrepancy between the projected revenues of the proponents (\$700 million) and the projected revenues of the Legislative Analyst (\$500 million)?

22. To what extent, if any, would the lottery reduce parimutuel revenues from horseracing?

23. Are there any indirect fiscal effects which might result from a state lottery, including possible loss of sales tax revenues should purchase of lottery tickets divert disposable income from the purchase of taxable goods?

24. Are lottery revenues sufficiently stable to enable educational institutions to rely on these revenues over time?

25. Is the 16% overhead provision too much given the economies of scale that should be apparent in California? Will it encourage excessive overhead expenses?

26. The initiative authorizes continuous appropriation of commission overhead expenditures (\$8880.62) which, in effect, exempts the commission from legislative review in the annual Budget Act. Why shouldn't the commission's budget for expenses be subject to approval in the annual Budget Act? Is this the usual practice in other states?

Miscellaneous

27. The initiative permits amendment of its provisions "to further its purposes." What does this phrase mean? What latitude will be given to the Legislature and Governor to determine that any proposed amendments will meet this standard?

APPENDIX A

Salary ranges in the U.S. Lottery Industry

Lottery	Official	Title	Salary (range)	Lottery Sales (fiscal 1983, in millions)	State Population (in millions)
Arizona	Charles E. Buri	Director	\$51,000	75	2.4
	Scott Phelps	Deputy Director	\$45,000		
Colorado	Owen W. Hickey	Director	\$39,576-\$52,956	215 (projected)	2.7
	Tim Smith	Deputy Director	\$27,492-\$48,108		
	Leon Tuttle	Director of Administration	\$32,556-\$43,632		
	Bill Russell	Research & Development	\$34,188-\$45,828		
Connecticut	J. Blaine Lewis Jr.	Unit Chief ¹	\$47,000 ¹	190	3.1
	Greg Ziemak	Assistant Unit Chief	\$35,500		
Delaware	Ralph F. Batch	Director	\$47,610	30	.6
	Frank D. Brown	Deputy Director (finance)	\$30,585		
	Fred R. Cleaver	Deputy Director (operations)	\$30,585		
	Ted Manno	Deputy Director (marketing)	\$21,779		
Illinois	Michael J. Jones	Superintendent	\$39,000	495	11.3
	Jerry Havener	Deputy Superintendent	\$31,008-\$46,632		
Maine	Richard J. "Spike" Carey	Director	\$30,000	3.7	1.1
	Harold Lessard	Marketing	\$21,000		
	Bruce Doyle	Finance Officer	\$19,000		
Maryland	Martin M. Puncke	Executive Director	\$48,800	462.8	4.2
	Robert J. Laird	Deputy Director (marketing)	\$44,500		
	Machin Whittemore	Deputy Director (administration, finance & operations)	\$44,500		
	A. Milburn	Deputy Director (research & development)	\$44,500		
Massachusetts	James Hosker	Executive Director	\$65,000	350	5.8
	Thomas O'Heir	Assistant Director	\$52,000		
	Edmund O'Riordan	Divisional Director (finance) Marketing	\$46,000		
	Louis Totino	Divisional Director (marketing)	\$46,000		
New Hampshire	(Position unfilled at press time)	Executive Director	\$32,000-\$39,000	15	.9
	James Fawcett	Executive Officer	\$24,000-\$29,000		
New Jersey	Hazel Frank Gluck	Executive Director	\$54,706	693	7.4
	Joe Mulé	Deputy Director (administration)	\$54,000		
	Anthony Battista	Deputy Director (operations)	\$42,500		
	Judy Berry	Deputy Director (marketing)	\$42,500		
	Barbara Steele	Deputy Director (planning research)	\$38,500		
	John Gallagher	Chief Accountant	\$38,265		
New York	John D. Quinn	Security	\$35,000	700 (est.)	17.9
	Russell V. Gladieux	Director	\$59,890		
Ohio	Thomas V. Chema	Executive Director	\$49,317	400.9	10.7
	Donald Bean	Assistant Director	\$40,019		
	Nancy W. Wolpe	Deputy Director (administration)	\$28,080		
	John Forristal	Deputy Director (finance)	\$31,138		
	William Bright	Deputy Director (operations)	\$34,507		
	David Gale	Deputy Director (marketing)	\$26,374		

Lottery	Official	Title	Salary (range)	Lottery Sales (fiscal 1983, in millions)	State Population (in millions)
Pennsylvania	Lynn R. Nelson Bernard Edwards	Executive Director Deputy Executive Director	\$33,193-\$44,577 \$30,357-\$40,939	830	11.8
Rhode Island	Major Peter J. O'Connell Raymond E. Grimes N/A N/A N/A	Lottery Executive Director Deputy Director Financial Adminis- tration Production Manager Marketing Manager	\$47,692 \$36,439 \$31,469 \$21,532 \$24,844	43.7	.9
Vermont	George Dacey ² Conrad T. Shumway George M. Norrie	Executive Director Marketing Manager Deputy Director	\$30,000 ² \$33,000 \$27,000	4.6	.5
Washington, DC	Chester C. Carter ³ Willis Johnson George Thomas III Norval Perkins	Executive Director Deputy Director Comptroller Lottery Division Chief	\$63,700 \$46,302 \$51,058 \$57,866	68	.7
Washington State	Robert A. Boyd (Position unfilled at press time) William Robinson N.A. Stussy Janie Bailey	Director Deputy Director Assistant Director (administration) Assistant Director (operations) Assistant Direc- tor (marketing)	\$56,700 \$53,292 \$42,670 \$42,670 \$42,670	197	3.7

GB

¹Unit chief salary equals \$47,000 + management incentive bonus in 1983; bonus should bring salary up to approximately \$50,000.

²Starting salary for the executive director is set by statute; Dacey assumed the post in November. The range of his salary can extend as high as \$45,000.

³Carter resigned his post effective Dec. 31; former executive director Douglass Gordon is currently filling the position.

APPENDIX B

OWEN K. KUNS²
RAY H. WHITAKER
CHIEF DEPUTIES

JERRY L. BASSETT
KENT L. DECHAMBEAU
STANLEY M. LOURIMORE
EDWARD K. PURCELL
JOHN T. STUDEBAKER

JAMES L. ASHFORD
JOHN CORZINE
ROBERT CULLEN DUFFY
ROBERT D. GRONKE
SHERWIN C. MACKENZIE, JR.
ANN M. MACKAY
TRACY O. POWELL, II
JIMMIE WING
PRINCIPAL DEPUTIES

3021 STATE CAPITOL
SACRAMENTO 95814
(916) 445-3057

8011 STATE BUILDING
107 SOUTH BROADWAY
LOS ANGELES 90012
(213) 620-2550

Legislative Counsel of California

BION M. GREGORY

Sacramento, California

April 12, 1984

Honorable Richard Alatorre
Assembly Chamber

Lottery Initiative - #7290

Dear Mr. Alatorre:

You have furnished us with a copy of a proposed initiative measure which would amend Section 19 of Article IV of the California Constitution to authorize the establishment of a state lottery and would add Chapter 12.5 (commencing with Section 8880) to Division 1 of Title 122 of the Government Code, which would be known as the California State Lottery Act of 1984. The measure would establish the California State Lottery Commission and provide for the appointment of a director to administer the operation of the lottery as provided therein.

QUESTION

Does the initiative measure permit the use of video lottery terminals in which money could be deposited and which would indicate immediately whether the player had won a prize?

OPINION

The initiative measure does not permit the use of video lottery terminals in which money could be deposited and which would indicate immediately whether the player had won a prize.

DAVID D. ALVES
MARTIN L. ANDERSON
PAUL ANTILLA
CHARLES C. ASBILL
SHARON G. BIRENBAUM
AMELIA I. BUDD
EILEEN J. BUXTON
HENRY J. CONTRERAS
BEN E. DALE
CLINTON J. DEWITT
C. DAVID DICKERSON
KATHRYN E. DONOVAN
FRANCES S. DORBIN
MAUREEN S. DUNN
LAWRENCE H. FEIN
SHARON R. FISHER
JOHN FOSSETTE
HARVEY J. FOSTER
CLAY FULLER
ALVIN D. GRESS
JOYCE E. HEE
THOMAS R. HEUER
JACK I. HORTON
SANDRA HUGHES
MICHAEL J. KERSTEN
L. DOUGLAS KINNEY
VICTOR KOZIELSKI
EVE KROTINGER
ROMULO I. LOPEZ
JAMES A. MARSALA
PETER MELNICOE
ROBERT G. MILLER
JOHN A. MOGER
VERNE L. OLIVER
EUGENE L. PAINE
ISA R. RODRIGUEZ
MARGUERITE ROTH
MICHAEL B. SALERNO
MARY SHAW
ANN ELLIOTT SHERMAN
RUSSELL L. SPARLING
WILLIAM K. STARK
MARK FRANKLIN TERRY
JEFF THOM
MICHAEL H. UPSON
RICHARD B. WEISBERG
DANIEL A. WEITZMAN
THOMAS D. WHELAN
CHRISTOPHER ZIRKLE
DEPUTIES

ANALYSIS

The initiative measure would add the following provisions to the Government Code which are pertinent to the question posed:

"8880.2. Except for the state-operated lottery established by this Chapter, nothing in this Chapter shall be construed to repeal or modify existing State law and with respect to the prohibition of casino gambling, punch boards, slot machines, dog racing, video poker or blackjack machines paying prizes, or any other forms of gambling.

"8880.6. It is specifically found that Penal Code Sections 320, 321, 322, 323, 324, 325, 326, and 328 shall not apply to the California State Lottery or its operations.

"8880.28. The Commission shall promulgate rules and regulations specifying the types of Lottery Games to be conducted by the Lottery, provided:

"(a) No Lottery Game may use the theme of bingo, roulette, dice, baccarat, blackjack, Lucky 7's, draw poker, slot machines, dog racing, or horse racing.

"(b) In Lottery Games utilizing tickets, each ticket in such games shall bear a unique number distinguishing it from every other ticket in such game; and no name of an elected official shall appear on such tickets.

"(c) In games utilizing computer terminals or other devices, no coins or currency shall be dispensed to players from such computer terminals or devices." (Emphasis added.)

The initiative measure does not specifically state that video lottery terminals will be used, nor does it describe their use, except to prohibit the dispensing of coins or currency to the players by them (proposed Sec. 8880.28, Gov. C.). Further, the measure expressly makes the provisions of the Penal Code relating to lotteries inapplicable to the proposed state lottery (proposed Sec. 8880.6, Gov. C.), but does not so provide with respect to provisions of the Penal Code relating to gaming, slot machines, punch boards, and other devices (Ch. 10 (commencing with Sec. 330), Title 9, Pt. 1, Pen. C.).

Proposed Section 8880.2 of the Government Code provides that, except for the state-operated lottery established by the initiative, the measure shall not be construed to repeal or modify laws relating to gambling, including punch boards and slot machines.

Under the rule of statutory construction, expressio unius est exclusio alterius, if a statute contains an express exception or exceptions, it will be presumed that no other exceptions were intended (In re De Neef, 42 Cal. App. 2d 691, 694).

Here, laws relating to gambling devices, such as slot machines and punch boards, which could have been made inapplicable to the proposed state lottery, were not made inapplicable, while laws relating to lotteries were expressly made inapplicable. Furthermore, the initiative measure expressly prohibits the use of the theme of slot machines in any lottery game (proposed subd. (a), Sec. 8880.28, Gov. C.).

Therefore, by the terms of the initiative measure, we conclude that laws relating to gaming, as set forth in Chapter 10 (commencing with Section 330), Title 9, Part 1 of the Penal Code are not repealed or modified by the proposed state lottery.

Subdivision (b) of Section 330b of the Penal Code which, among other things, prohibits the possession or operation of slot machines, defines a slot machine as follows:

"330b.

* * *

"(2) Any machine, apparatus or device is a slot machine or device within the provisions of this section if it is one that is adapted, or may readily be converted into one that is adapted, for use in such a way that, as a result of the insertion of any piece of money or coin or other object, or by any other means, such machine or

device is caused to operate or may be operated, and by reason of any element of hazard or chance or of other outcome of such operation unpredictable by him, the user may receive or become entitled to receive any piece of money, credit, allowance or thing of value or additional chance or right to use such slot machine or device, or any check, slug, token or memorandum, whether of value or otherwise, which may be exchanged for any money, credit, allowance or thing of value, or which may be given in trade, irrespective of whether it may, apart from any element of hazard or chance or unpredictable outcome of such operation, also sell, deliver or present some merchandise, indication of weight, entertainment or other thing of value.

* * * (Emphasis added.)

We think that a video lottery terminal in which money could be deposited and which would indicate immediately whether the player had won a prize would come within the definition of a slot machine, and that the use or possession of such a video lottery terminal would therefore be prohibited (Secs. 330b and 330.1, Pen. C.) (see also Merandette v. City and County of San Francisco, 88 Cal. App. 3d 105, in which the court held that coin-operated video machines for blackjack were slot machines and came within the prohibition of Section 330b).

Therefore, in our opinion the initiative measure does not permit the use of video lottery terminals in which money could be deposited and which would indicate immediately whether the player had won a prize.

Very truly yours,

Bion M. Gregory
Legislative Counsel

By 
Paul Antilla
Deputy Legislative Counsel

PA:jm

SUMMARY OF U.S. LOTTERY LAWS

	AZ	CA (Prop. 37)	CT	DEL	ILL	ME	MD	MASS
LOTTERY COMMISSION	X	X	X		X	X	X	X
Number of Members	5	5	5		5	5	5	5
Governor Appoints	X	X	X		X	X	X	X
Senate Confirmation	X	X	X		X		X	
Per Diem	\$30	\$100 + expenses	\$50		\$100	\$25	expenses only	expenses only
COMMISSION AUTHORITY								
Type of Games	X	X	X		X	X	X	X
Ticket Price	X	X	X		X	X	X	X
Revenue Apportionment	X				X	X	X	
Agents: License and Compensation	X					X	X	X
LOTTERY ADMINISTRATORS								
Type of Games				X				
Ticket Price				X				
Revenue Apportionment								
Agents: License and Compensation				X				
Purchase Restrictions- Minors	X	X	X	X	X	X	X	X
DISTRIBUTION GROSS SALES								
Prize Money	45%			45%		45%	50%*	45% min.
Operating Expenses		16% max.		20% max.				15% max.
Revenue to State	30% min	50% min.		30% min.		40% min	50%*	
DISTRIBUTION NET INCOME								
General Fund	X		X	X	X	X	X	
Education		X						
Aid to Elderly								
Prize Money Exempt (State and Local Taxes)	exempt state tax	X		X		X		

SUMMARY OF U.S. LOTTERY LAWS

	MICH	NH	NJ	NY	OHIO	PENN	RI	VT
LOTTERY COMMISSION		X	X		X	X	X	X
Number of Members		3	5		9	5	9	5
Governor Appoints		X	X		X	X	X	X
Senate Confirmation		X	X		X	X	X	X
Per Diem		\$2400 annual	expenses only		\$5000 annual		expenses only	\$30
COMMISSION AUTHORITY								
Type of Games		X	X		X		X	X
Ticket Price		X	X		X		X	X
Revenue Apportionment			X				X	X
Agents: License and Compensation			X		X		X	X
LOTTERY ADMINISTRATORS	X			X				
Type of Games	X			X				
Ticket Price	X			X				
Revenue Apportionment	X							
Agents: License and Compensation	X			X				
Purchase Restrictions- Minors	X	X	X	X	X	X	X	X
DISTRIBUTION GROSS SALES								
Prize Money	45%			40% max.	45%	40% min.	45% min.	50% min.
Operating Expenses				15% max.				
Revenue to State			30% min.	45% min.	30% min.		30% min.	
DISTRIBUTION NET INCOME								
General Fund					X		X	X
Education	X	X	X	X		X	X	
Aid to Elderly								
Prize Money Exempt (State and Local Taxes)	X	X	X			X	X	X

* Maryland requires 50% of the net of the non-daily game.

NOTE: Date compiled by the Colorado Legislative Interim Committee
Does not include Colorado, Washington, and the District of Columbia

COMPARISON OF LOTTERY MEASURES

	ACA 6 (BANE)	ACA 8 (HUGHES)	ACA 13 (BRADLEY)	FADEM INITIATIVE
Governing Body	13-member State Lottery Commission. 2 appointed by Governor; 2 by Senate Rules; 2 by Assembly Speaker. Other members are Attorney General, Superintendent of Public Instruction, Treasurer, and 4 mayors.	Unspecified	Department of Consumer Affairs	5-member California State Lottery Commission. All appointed by Governor, subject to Senate confirmation.
Administrative Structure	Commission hires director	Unspecified	Unspecified	Governor appoints director subject to Senate confirmation.
Game Formats	No restriction.	No restriction.	No restriction.	Prohibits game theme based on horseracing, bingo or casino games.
Allocation of Receipts	Unspecified	Prizes-50% Expenses-15% Revenues-35%	Unspecified	Prizes - 50% Expenses-16% Revenues-34%
Allocation of Revenues	Public education	Public education capital outlay projects in grades K-12.	General Fund	Public education instructional programs at grades K-12, community colleges, CSUC and UC.

Start-Up Costs	Commission may borrow up to \$100,000 from General Fund and up to \$500,000 from Pooled Money Investment Fund.	Unspecified	Unspecified	Commission may borrow up to \$16.5 million from General Fund.
Other Features				<p>Prohibits Legislature from authorizing casino-style gambling.</p> <p>Exempts winnings from state and local taxes.</p> <p>Requires first ticket sales within 135 days.</p> <p>Requires demographic study of lottery players.</p> <p>Requires licensing of lottery game retailers.</p> <p>Provides special contracting procedures for lottery game suppliers.</p> <p>Exempts commission expenses from budget review.</p> <p>Prohibits amendment except by 2/3 vote of Legislature.</p>

PROPOSITION 37--THE CALIFORNIA STATE LOTTERY INITIATIVE

STATEMENT TO THE ASSEMBLY COMMITTEE ON GOVERNMENTAL ORGANIZATION
SACRAMENTO, AUGUST 22, 1984

MR. CHAIRMAN AND MEMBERS:

YOU HAVE ASKED THAT WE PROVIDE TESTIMONY REGARDING THE FISCAL EFFECTS OF THE CALIFORNIA STATE LOTTERY INITIATIVE, WHICH WILL APPEAR AS PROPOSITION 37 ON THE STATEWIDE BALLOT ON NOVEMBER 6, 1984. IN PARTICULAR, YOU HAVE ASKED THAT WE PROVIDE AN OVERVIEW OF THE INITIATIVE'S PROVISIONS AND THEN DISCUSS EIGHT SPECIFIC QUESTIONS REGARDING THE FISCAL IMPLICATIONS WHICH THIS MEASURE, IF APPROVED, WOULD HAVE.

A. MAJOR PROVISIONS OF THE INITIATIVE

PROPOSITION 37 WOULD MAKE BOTH CONSTITUTIONAL AND STATUTORY LAW CHANGES REGARDING GAMBLING ACTIVITY IN CALIFORNIA.

1. CONSTITUTIONAL PROVISIONS OF THE INITIATIVE

PROPOSITION 37 WOULD AMEND THE CALIFORNIA CONSTITUTION IN TWO WAYS:

- IT WOULD AUTHORIZE ESTABLISHMENT OF A STATEWIDE LOTTERY IN CALIFORNIA. (THE CONSTITUTION PRESENTLY PROHIBITS LOTTERIES).
- IT WOULD PROHIBIT GAMBLING CASINOS IN CALIFORNIA OF THE TYPE THAT EXIST IN NEVADA AND NEW JERSEY. (CASINO GAMBLING CURRENTLY IS PROHIBITED WITHIN CALIFORNIA BY A STATUTE, BUT NOT BY THE CONSTITUTION.)

2. STATUTORY PROVISIONS OF THE INITIATIVE

PROPOSITION 37 WOULD ALSO ENACT AN INITIATIVE STATUTE, CALLED THE CALIFORNIA STATE LOTTERY ACT OF 1984, WHICH PROVIDES FOR THE ACTUAL ESTABLISHMENT OF A STATE-OPERATED LOTTERY. THE ACT'S MAIN PROVISIONS ARE AS FOLLOWS:

A. LOTTERY ADMINISTRATION

THE ACT WOULD ESTABLISH A CALIFORNIA STATE LOTTERY COMMISSION AND GIVE IT BROAD POWERS TO OVERSEE THE OPERATIONS OF THE STATEWIDE LOTTERY, WITH THE STATED OBJECTIVE BEING TO MAXIMIZE NET REVENUES FROM THE LOTTERY. THE COMMISSION WOULD BE RESPONSIBLE FOR DETERMINING THE TYPES OF LOTTERIES TO BE HELD, THE FREQUENCY OF LOTTERY DRAWINGS, THE PRICE OF LOTTERY TICKETS, THE NUMBER AND AMOUNT OF LOTTERY PRIZES, AND THE LOCATIONS WHERE LOTTERY TICKETS MAY BE SOLD.

THE COMMISSION WOULD HAVE FIVE MEMBERS WHO, ALONG WITH A LOTTERY DIRECTOR, WOULD BE APPOINTED BY THE GOVERNOR AND CONFIRMED BY THE CALIFORNIA SENATE. THE MEASURE WOULD REQUIRE THAT AT LEAST ONE OF THE FIVE COMMISSIONERS HAVE A BACKGROUND IN LAW ENFORCEMENT, AND THAT AT LEAST ONE BE A CERTIFIED PUBLIC ACCOUNTANT. NO MORE THAN THREE OF THE FIVE COMMISSIONERS COULD BE MEMBERS OF THE SAME POLITICAL PARTY.

THE COMMISSION WOULD BE REQUIRED TO MAKE QUARTERLY REPORTS ON THE PERFORMANCE OF THE LOTTERY. THE DIRECTOR WOULD BE REQUIRED TO ARRANGE FOR STUDIES OF HOW THE LOTTERY COULD BE OPERATED MOST EFFECTIVELY, WHO PARTICIPATES IN THE LOTTERY, AND THE BEST MEANS OF PROMOTING THE LOTTERY SO AS TO MAXIMIZE LOTTERY REVENUES.

B. LOTTERY IMPLEMENTATION

THE COMMISSION WOULD BE REQUIRED TO BEGIN PUBLIC SALE OF LOTTERY TICKETS NO LATER THAN 135 DAYS AFTER THE EFFECTIVE DATE OF THIS MEASURE (THAT IS, BY APRIL 1985). LOTTERY TICKETS COULD BE PURCHASED ONLY BY INDIVIDUALS AGED 18 YEARS OR OLDER. THE MEASURE WOULD PROVIDE THE COMMISSION WITH A \$16.5 MILLION TEMPORARY LINE OF CREDIT FROM THE GENERAL

FUND TO COVER THE START-UP COSTS ASSOCIATED WITH A STATE LOTTERY. THE COMMISSION COULD DRAW ON THIS LINE OF CREDIT DURING THE 12 MONTHS FOLLOWING THE EFFECTIVE DATE OF THE MEASURE. THE COMMISSION WOULD HAVE TO REPAY ANY BORROWED FUNDS, WITH INTEREST AT AN ANNUAL RATE OF 10 PERCENT, WITHIN 12 MONTHS OF RECEIVING THE FUNDS.

C. ALLOCATIONS OF THE PROCEEDS FROM LOTTERY SALES

THE MEASURE WOULD REQUIRE ALL REVENUES FROM LOTTERY SALES TO BE DEPOSITED INTO A NEW SPECIAL FUND CALLED THE STATE LOTTERY FUND. FIFTY PERCENT OF THESE PROCEEDS FROM LOTTERY TICKET SALES WOULD BE PAID OUT AS LOTTERY PRIZES, AND A MAXIMUM OF 16 PERCENT COULD BE USED FOR ADMINISTRATIVE COSTS (INCLUDING COMMISSIONS TO SELLERS OF LOTTERY TICKETS). THE LOTTERY PRIZES WOULD BE EXEMPT FROM STATE (BUT NOT FEDERAL) INCOME TAXES. THE REMAINDER OF THE PROCEEDS FROM TICKET SALES--AT LEAST 34 PERCENT OF THE TOTAL--WOULD BE TRANSFERRED INTO A NEW SPECIAL FUND (THE STATE LOTTERY EDUCATION FUND) FROM WHICH MONIES WOULD BE CONTINUOUSLY APPROPRIATED FOR THE BENEFIT OF PUBLIC EDUCATION. ANY UNCLAIMED LOTTERY PRIZES AND UNUSED FUNDS AVAILABLE FOR ADMINISTRATIVE COSTS WOULD ALSO BE PLACED INTO THIS FUND.

THE MEASURE REQUIRES THAT THE FUNDS MADE AVAILABLE FOR PUBLIC EDUCATION BE DIVIDED AMONG THE FOLLOWING FOUR CATEGORIES OF PUBLIC EDUCATION: KINDERGARTEN-THROUGH-TWELFTH GRADE (K-12), COMMUNITY COLLEGES, THE CALIFORNIA STATE UNIVERSITY (CSU), AND THE UNIVERSITY OF CALIFORNIA (UC). THE FUNDS WOULD BE DISTRIBUTED PERIODICALLY BY THE STATE CONTROLLER ON A "PER CAPITA" BASIS. THIS PROBABLY WOULD BE INTERPRETED IN TERMS OF AVERAGE DAILY ATTENDANCE OR FULL-TIME EQUIVALENT ENROLLMENT. THE MEASURE

STATES THE INTENT THAT THE FUNDS MADE AVAILABLE FOR PUBLIC EDUCATION ARE TO BE USED TO AUGMENT (RATHER THAN SUBSTITUTE FOR) FUNDS ALREADY ALLOCATED FOR PUBLIC EDUCATION IN CALIFORNIA, AND THAT THE FUNDS ARE TO BE SPENT EXCLUSIVELY FOR INSTRUCTIONAL PURPOSES.

B. FISCAL EFFECTS OF THE INITIATIVE

YOU HAVE ASKED THAT WE DISCUSS THE FOLLOWING EIGHT SPECIFIC QUESTIONS REGARDING THE FISCAL EFFECTS OF PROPOSITION 37. EACH OF THESE QUESTIONS IS SEPARATELY ADDRESSED BELOW.

1. THE AMOUNT OF NET REVENUES WHICH THE LOTTERY WOULD PRODUCE

YOU HAVE ASKED WHAT OUR ESTIMATE IS OF HOW MUCH IN NET REVENUES WOULD BE MADE AVAILABLE FOR PUBLIC EDUCATION IF THE LOTTERY INITIATIVE SHOULD PASS, AND WHEN THESE REVENUES WOULD BECOME AVAILABLE.

RESPONSE

ESTIMATING THE AMOUNT OF LOTTERY PROCEEDS AVAILABLE TO PUBLIC EDUCATION INVOLVES TWO STEPS:

- ESTIMATING THE TOTAL DOLLAR VOLUME OF LOTTERY TICKET SALES WHICH WILL OCCUR, AND
- MULTIPLYING THIS SALES VOLUME BY THE SHARE OF LOTTERY RECEIPTS WHICH IS TO BE ALLOCATED TO PUBLIC EDUCATION.

SHARE OF LOTTERY RECEIPTS GOING TO EDUCATION. AS NOTED EARLIER, PROPOSITION 37 REQUIRES THAT PUBLIC EDUCATION RECEIVE A MINIMUM OF 34 PERCENT OF MONIES RAISED FROM THE SALE OF LOTTERY TICKETS. IN ADDITION, PUBLIC EDUCATION IS TO RECEIVE ALL UNCLAIMED PRIZE MONIES, PLUS THE AMOUNT BY WHICH THE EXPENSES INCURRED IN OPERATING THE LOTTERY ARE LESS THAN 16 PERCENT OF TICKET SALES. WE HAVE NO WAY OF KNOWING FOR SURE EXACTLY WHAT

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THE VOLUME OF UNCLAIMED PRIZE MONIES OR THE EXPENSES OF LOTTERY OPERATIONS WILL BE IN CALIFORNIA AS A PERCENT OF SALES. HOWEVER, BASED ON THE EXPERIENCE OF OTHER STATES, WE BELIEVE THAT THESE TWO FACTORS COULD, ONCE THE LOTTERY IS FULLY OPERATIONAL SO THAT START-UP COSTS ARE NO LONGER A FACTOR AND ON-GOING EXPENSES ARE SPREAD OVER A LARGE SALES BASE, ADD AN ADDITIONAL 6 PERCENT TO THE SHARE OF TICKET SALES ALLOCATED TO EDUCATION. GIVEN THIS, WE BELIEVE THAT PUBLIC EDUCATION COULD RECEIVE 40 PERCENT OF LOTTERY SALES RECEIPTS, ASSUMING A FULLY-OPERATIONAL LOTTERY.

VOLUME OF LOTTERY TICKET SALES. IT IS DIFFICULT TO ACCURATELY PREDICT AT THIS TIME THE AMOUNT OF LOTTERY TICKET SALES WHICH WOULD OCCUR IN CALIFORNIA UNDER PROPOSITION 37. THERE ARE SEVERAL REASONS FOR THIS. FOR EXAMPLE:

- THE INITIATIVE DOES NOT SPECIFY WHAT TYPES OF LOTTERY GAMES WILL BE MADE AVAILABLE IN CALIFORNIA, HOW FREQUENTLY THE GAMES WILL BE PLAYED, OR WHAT THE NUMBER AND LOCATIONS OF LOTTERY TICKET SALES OUTLETS WILL BE.
- BECAUSE CALIFORNIA HAS NEVER HAD A LOTTERY BEFORE, THERE IS NO WAY OF KNOWING IN ADVANCE EXACTLY HOW CALIFORNIANS WILL RESPOND TO DIFFERENT LOTTERY GAMES.
- DATA ON LOTTERY TICKET SALES ARE AVAILABLE FOR LOTTERIES IN 17 OTHER STATES AND THE DISTRICT OF COLUMBIA, AND ONE CERTAINLY CAN ATTEMPT TO USE THESE DATA TO MAKE INFERENCES ABOUT THE POTENTIAL VOLUME OF CALIFORNIA LOTTERY TICKET SALES. HOWEVER, IN ORDER TO DO THIS IN A STATISTICALLY-VALID MANNER, IT IS FIRST NECESSARY TO SEPARATE OUT THE INDEPENDENT INFLUENCES OF THE MANY FACTORS THAT

DETERMINE LOTTERY SALES IN OTHER STATES, SO THAT CALIFORNIA'S OWN UNIQUE CHARACTERISTICS CAN BE TAKEN INTO ACCOUNT WHEN PROJECTING LOTTERY SALES. UNFORTUNATELY, HOWEVER, ACCURATELY IDENTIFYING THE SEPARATE EFFECTS OF ALL OF THESE FACTORS IS AN EXTREMELY COMPLEX TASK, AND WE ARE NOT AWARE OF ANYONE WHO HAS BEEN ABLE TO ACCOMPLISH THIS IN A TOTALLY SATISFACTORY WAY.

- MOST STATES HAVE EITHER RECENTLY EXPANDED THEIR LOTTERY OPERATIONS TO INCLUDE "LOTTO" GAMES, OR PLAN TO DO SO IN THE NEAR FUTURE. LOTTO GAMES REPRESENT THE FASTEST-GROWING FORM OF LOTTERY BETTING RIGHT NOW, AND THE EVIDENCE SO FAR IS THAT THEY COULD BECOME TREMENDOUSLY POPULAR. HOWEVER, BECAUSE THEY ARE RELATIVELY NEW, NO ONE CAN BE SURE FROM THE EXPERIENCES-TO-DATE OF OTHER STATES WHAT TYPES OF SALES LEVELS LOTTO GAMES COULD PRODUCE IN CALIFORNIA, ONCE THEY ARE FULLY PHASED-IN.

GIVEN THESE PROBLEMS, WE HAVE CONCLUDED THAT THE BEST APPROACH TO PROJECTING CALIFORNIA LOTTERY SALES AT THIS TIME IS TO REVIEW THE TOTAL AND PER CAPITA LOTTERY SALES LEVELS IN OTHER STATES (TABLE 1), AND THEN TO (A) FOCUS ON STATES WHICH ARE EITHER LARGE INDUSTRIAL STATES LIKE CALIFORNIA OR GEOGRAPHICALLY PROXIMATE TO CALIFORNIA AND (B) ADJUST FOR THE FACT THAT LOTTERY "NUMBERS GAMES" MIGHT NEVER BECOME AS IMPORTANT A SOURCE OF LOTTERY SALES IN CALIFORNIA AS IN THE EAST AND MIDWEST WHERE, UNLIKE IN CALIFORNIA, NUMBER GAMES HAVE BEEN POPULAR FOR DECADES.

USING THIS APPROACH, WE ESTIMATE THAT LOTTERY SALES IN CALIFORNIA WOULD BE ABOUT \$50 PER CAPITA, OR ABOUT \$1.25 BILLION FOR THE STATE AS A WHOLE ONCE A LOTTERY IS FULLY OPERATIONAL. THIS VOLUME OF SALES WOULD

TABLE 1
TOTAL AND PER CAPITA LOTTERY SALES
IN 1982-83 AND 1983-84

STATE	TOTAL LOTTERY SALES (MILLIONS OF DOLLARS) ^A		PER CAPITAL LOTTERY SALES	
	1982-83	1983-84	1982-83	1983-84
ARIZONA	\$75	\$60	\$26	\$20
COLORADO	137 ^B	118	45 ^B	38
CONNECTICUT	188	250	60	80
DELAWARE	30	33	50	55
DISTRICT OF COLUMBIA	54 ^C	98	86 ^C	157
ILLINOIS	516	914	45	80
MAINE	13	16	12	14
MARYLAND	463	537	108	125
MASSACHUSETTS	316	450 ^D	55	78 ^D
MICHIGAN	553	621	61	68
NEW HAMPSHIRE	14	18	15	19
NEW JERSEY	693	800	93	107
NEW YORK	645	889	37	50
OHIO	397	600	37	56
PENNSYLVANIA	885	1,236	75	104
RHODE ISLAND	44	53	46	55
VERMONT	5	5	9	10
WASHINGTON	200 ^E	165	47 ^E	38
ALL LOTTERY STATES	\$5,228	\$6,863	\$50 ^F	\$64 ^F

- A. DATA FROM STATE LOTTERY COMMISSIONS AND PUBLIC GAMING RESEARCH INSTITUTE. DATA FOR 1983-84 ARE PRELIMINARY ESTIMATES FOR CERTAIN STATES, INCLUDING NEW JERSEY AND OHIO.
- B. LOTTERY SALES BEGAN JANUARY 24, 1983.
- C. LOTTERY SALES BEGAN AUGUST 25, 1982.
- D. REFLECTS LOTTERY SALES FOR THE FIRST 11 MONTHS OF THE FISCAL YEAR.
- E. LOTTERY SALES BEGAN NOVEMBER 15, 1982.
- F. UNWEIGHTED AVERAGE OF ALL LOTTERY STATES.

YIELD \$500 MILLION IN ANNUAL REVENUES FOR CALIFORNIA PUBLIC EDUCATION, BASED ON THE ASSUMPTION ABOVE THAT EDUCATION RECEIVES A 40 PERCENT SHARE.

OUR ESTIMATE OF \$500 MILLION IN NET REVENUES IS LESS THAN THE \$700 MILLION ESTIMATE ASCRIBED TO THE INITIATIVE'S PROPONENTS. THIS IS BECAUSE THE \$700 MILLION ESTIMATE IS BASED ON PARTIAL YEAR SALES DATA FOR TWO STATES (WASHINGTON AND COLORADO) DURING THE EARLY MONTHS OF THEIR FIRST YEAR OF OPERATION (1982-83). THESE SALES VOLUMES ARE NOT REPRESENTATIVE OF THE ONGOING EFFECTS OF THE LOTTERIES. IN CONTRAST, OUR FIGURE IS BASED ON LOTTERY PERFORMANCE IN THESE TWO STATES PLUS IN TEN OTHER STATES AS WELL, IN THE MOST RECENT FISCAL YEAR (1983-84).

THUS, OUR ESTIMATE REFLECTS A BROADER SPECTRUM AND MORE RECENT EXPERIENCE OF LOTTERY ACTIVITY THAN DOES THE \$700 MILLION ESTIMATE.

WHEN LOTTERY REVENUES WOULD BECOME AVAILABLE. BECAUSE PROPOSITION 37 REQUIRES THE PUBLIC SALE OF LOTTERY TICKETS BY APRIL 1985, REVENUES WOULD FIRST BECOME AVAILABLE IN 1984-85. HOWEVER, THESE REVENUES WOULD BE FAR LESS THAN \$500 MILLION, BECAUSE THERE WOULD ONLY BE A PARTIAL YEAR EFFECT IN 1984-85. IN 1985-86, REVENUES WOULD ALSO BE LESS THAN \$500 MILLION, BECAUSE IT TAKES TIME TO FULLY IMPLEMENT AN ARRAY OF LOTTERY GAMES AND REALIZE THEIR FULL REVENUE POTENTIAL. FOR EXAMPLE, LOTTERY OFFICIALS IN OTHER STATES INDICATED TO US THAT IT CAN TAKE A YEAR OR MORE TO BEGIN LOTTO GAMES, DUE TO THE TIME REQUIRED TO IMPLEMENT THE NECESSARY "ON-LINE" COMPUTER EQUIPMENT AND TO ESTABLISH SATISFACTORY SECURITY SYSTEMS. CONSEQUENTLY, THE FULL ONGOING REVENUE IMPACT OF THE MEASURE PROBABLY WOULD NOT BE FELT UNTIL 1986-87.

2. THE DISTRIBUTION OF LOTTERY REVENUES AMONGST EDUCATION CATEGORIES

YOU HAVE ASKED HOW LOTTERY REVENUES WOULD BE ALLOCATED AMONGST THE STATE'S FOUR MAJOR EDUCATIONAL SYSTEMS--K-12, COMMUNITY COLLEGES, CALIFORNIA STATE UNIVERSITY (CSU), AND THE UNIVERSITY OF CALIFORNIA (UC).

RESPONSE

PROPOSITION 37 REQUIRES THAT THE LOTTERY REVENUES ALLOCATED FOR EDUCATIONAL PURPOSES SHALL BE DISTRIBUTED AMONGST THESE FOUR EDUCATIONAL CATEGORIES ON A "PER CAPITA" BASIS. WE BELIEVE THAT THIS PROVISION WOULD BE INTERPRETED AS REQUIRING THE FUNDS TO BE DISTRIBUTED IN EQUAL AMOUNTS PER AVERAGE DAILY ATTENDANCE (THE MEASUREMENT THE INITIATIVE REFERS TO FOR K-12 AND COMMUNITY COLLEGES) OR FULL-TIME EQUIVALENT ENROLLMENT (THE MEASUREMENT THE INITIATIVE REFERS TO FOR CSU AND UC). BASED UPON CURRENT 1984-85 ADA PROJECTIONS FOR K-12 AND COMMUNITY COLLEGES AND FTE PROJECTIONS FOR CSU AND UC, THE DISTRIBUTION OF LOTTERY REVENUES AMONGST EDUCATIONAL CATEGORIES WOULD BE ABOUT 80.1 PERCENT FOR K-12, 13.0 PERCENT FOR COMMUNITY COLLEGES, 4.5 PERCENT FOR CSU, AND 2.4 PERCENT FOR UC.

3. COMPARISON OF LOTTERY REVENUES ALLOCATED TO EDUCATION WITH CURRENT EDUCATIONAL FUNDING

YOU HAVE ASKED HOW THE LOTTERY REVENUES TO BE RECEIVED BY PUBLIC EDUCATIONAL INSTITUTIONS COMPARES WITH THE FUNDING CURRENTLY PROVIDED BY THE STATE TO THESE INSTITUTIONS FOR INSTRUCTIONAL PURPOSES.

RESPONSE

TABLE 2 SUMMARIZES THE FUNDING LEVELS IN 1983-84 AND 1984-85 PROVIDED BY THE STATE FOR K-12, COMMUNITY COLLEGES, CSU AND UC. THESE FIGURES

TABLE 2

CURRENT STATE FUNDING AND ESTIMATED
STATE LOTTERY REVENUES FOR EDUCATIONAL
CATEGORIES IN CALIFORNIA
(IN MILLIONS)

EDUCATIONAL CATEGORY	CURRENT EDUCATIONAL FUNDING ^A		PROJECTED EDUCATIONAL REVENUES FROM A FULLY-OPERATIONAL LOTTERY	
	1983-84	1984-85	AMOUNT	PERCENT OF 1984-85 FUNDING
1. K-12 EDUCATION	\$8,429	\$9,636	\$400	4.2%
2. POSTSECONDARY EDUCATION				
A. COMMUNITY COLLEGES	1,073	1,101	65	5.9
B. CSU	955	1,152	23	1.9
C. UC	1,125	1,375	12	0.9
SUBTOTAL	\$3,152	\$3,628	\$100	2.8%
TOTAL, K-12 AND POST- SECONDARY EDUCATION	\$11,581	\$13,264	\$500	3.8%

A. DETAIL MAY NOT ADD TO TOTALS DUE TO ROUNDING. FIGURES INCLUDE STATE SUPPORT FROM THE GENERAL FUND AND OTHER STATE FUNDS, BUT EXCLUDE FEDERAL FUNDING AND MAJOR CAPITAL OUTLAY EXPENDITURES. FIGURES FOR CSU AND UC CONTAIN CERTAIN FUNDING USED FOR RESEARCH ACTIVITIES WHICH CANNOT BE SEPARATELY IDENTIFIED USING CURRENTLY AVAILABLE DATA.

INCLUDE SUPPORT FROM BOTH THE GENERAL FUND AND OTHER STATE FUNDS, AND EXCLUDE FEDERAL FUNDS AND MAJOR CAPITAL OUTLAY FUNDING.

THE TABLE INDICATES THAT THE REVENUES AVAILABLE TO EDUCATION FROM A FULLY OPERATIONAL LOTTERY WOULD AMOUNT TO, AS A PERCENT OF 1984-85 STATE EDUCATIONAL FUNDING, ABOUT 4.2 PERCENT FOR K-12, 5.9 PERCENT FOR COMMUNITY COLLEGES, 1.9 PERCENT FOR CSU, 0.9 PERCENT FOR UC, AND 3.8 PERCENT FOR ALL OF THESE EDUCATIONAL CATEGORIES COMBINED.

4. THE STABILITY OF LOTTERY REVENUES OVER TIME

YOU HAVE ASKED WHAT OUR OPINION IS REGARDING THE STABILITY OF LOTTERY REVENUES OVER TIME AND, IN PARTICULAR, WHETHER LOTTERY REVENUES CAN BE RELIED UPON AS A STABLE FUNDING SOURCE FOR PUBLIC EDUCATION.

RESPONSE

THERE ARE TWO SEPARATE ASPECTS OF YOUR QUESTION. ONE ASPECT INVOLVES WHETHER, ON A LONG-TERM BASIS, LOTTERY REVENUES CAN BE EXPECTED TO "HOLD THEIR OWN" AND GROW IN STEP WITH THE GENERAL ECONOMY, AS OPPOSED TO "FALLING OFF" OVER TIME. THE SECOND ASPECT INVOLVES THE EXTENT TO WHICH, OVER THE NORMAL COURSE OF THE BUSINESS CYCLE, LOTTERY REVENUES WILL EXPERIENCE SHORT-TERM VARIABILITY.

REGARDING THE FIRST FACTOR--LONG-TERM STABILITY--THERE SEEMS TO SOME EVIDENCE FROM THE EXPERIENCES OF LOTTERIES IN OTHER STATES THAT LOTTERY GAMES FREQUENTLY GENERATE A RUSH OF ENTHUSIASM WHEN THEY ARE FIRST INTRODUCED, WITH REVENUES TO MATCH; HOWEVER, SALES LATER SAG AS THE NOVELTY OF THE GAMES WEARS OFF, UNLESS NEW VERSIONS ARE INTRODUCED. FOR EXAMPLE, THIS SEEMS TO HAVE OCCURRED IN BOTH ARIZONA (WHERE SALES DECLINED FROM \$114 MILLION IN 1981-82 TO \$75 MILLION IN 1982-83 AND \$60 MILLION IN 1983-84),

COLORADO (WHERE SALES DECLINED FROM \$137 MILLION IN THE LAST FIVE MONTHS OF 1982-83 TO \$118 MILLION FOR ALL OF 1983-84) AND WASHINGTON (WHERE SALES DECLINED FROM \$200 MILLION IN THE LAST 7½ MONTHS OF 1982-83 TO \$165 MILLION FOR ALL OF 1983-84). OUR OWN EXAMINATION OF INTERSTATE DIFFERENCES IN PER CAPITA LEVELS OF LOTTERY SALES INDICATES THAT, WHEN OTHER FACTORS SUCH AS HOUSEHOLD INCOME, UNEMPLOYMENT RATES AND THE PREVALENCE OF ALTERNATIVE TYPES OF LEGAL GAMBLING ARE ADJUSTED FOR, LOTTERY WAGERING TENDS TO FALL-OFF AS THE NUMBER OF YEARS A LOTTERY HAS BEEN IN EXISTENCE INCREASES. GIVEN THIS, WE BELIEVE THAT THERE WOULD BE SOME TENDENCY, AT LEAST FOR A PERIOD FOLLOWING THE ESTABLISHMENT OF A FULLY-OPERATIONAL LOTTERY, FOR THERE TO BE SOME FALL-OFF IN LOTTERY REVENUES UNLESS SUFFICIENTLY INNOVATIVE CHANGES IN LOTTERY GAMES THAT FUELED THE ENTHUSIASM OF BETTORS WERE CONTINUOUSLY MADE.

REGARDING THE SECOND FACTOR--SHORT-RUN VARIABILITY IN LOTTERY REVENUES IN RESPONSE TO FLUCTUATIONS IN ECONOMIC CONDITIONS--SEVERAL OPPOSING FORCES APPEAR TO BE AT WORK. ON THE ONE HAND, OUR INTERSTATE EXAMINATION OF LOTTERY ACTIVITY SUGGESTS THAT LOTTERY WAGERING APPEARS TO RISE AND FALL WITH INCOME. ON THE OTHER HAND, LOTTERY WAGERING ALSO SEEMS TO RISE AND FALL WITH THE UNEMPLOYMENT RATE. OF THESE TWO EFFECTS, THE CORRELATION BETWEEN LOTTERY WAGERING AND INCOME IS SOMEWHAT STRONGER THAN THAT BETWEEN WAGERING AND UNEMPLOYMENT. AS A RESULT, IT APPEARS THAT LOTTERY REVENUES CAN BE EXPECTED, ON BALANCE, TO RISE AND FALL WITH ECONOMIC ACTIVITY GENERALLY. IN THIS SENSE, SOME MIGHT CATEGORIZE LOTTERIES AS AN UNSTABLE SOURCE OF REVENUES IN THE SHORT-RUN SENSE. HOWEVER, IT SHOULD BE REMEMBERED THAT ALL OF THE STATE'S THREE MAJOR

GENERAL FUND INCOME SOURCES--THE PERSONAL INCOME TAX, THE SALES AND USE TAX, AND THE BANK AND CORPORATION TAX--ALSO SHARE THIS SAME GENERAL CHARACTERISTIC OF RISING AND FALLING ALONG WITH THE LEVEL OF ECONOMIC ACTIVITY GENERALLY.

5. THE ALLOCATION OF LOTTERY PROCEEDS IN OTHER STATES

YOU HAVE ASKED HOW THE ALLOCATION OF GROSS LOTTERY SALES RECEIPTS UNDER PROPOSITION 37 BETWEEN PRIZES, ADMINISTRATIVE EXPENSES AND PUBLIC PURPOSES COMPARES WITH THE ALLOCATION IN OTHER STATE LOTTERIES.

RESPONSE

TABLE 3 SUMMARIZES HOW EACH LOTTERY STATE SPLIT ITS GROSS LOTTERY TICKET SALES RECEIPTS AMONGST PRIZES, EXPENSES AND PUBLIC PURPOSES IN 1983-84. WHEN COMPARING THESE ALLOCATIONS TO THE ALLOCATION PROPOSED IN PROPOSITION 37 FOR CALIFORNIA, IT IS IMPORTANT TO RECOGNIZE THAT LOTTERY EXPENSES AS A PERCENT OF SALES TEND, ON AVERAGE, TO BE RELATIVELY HIGH FOR SMALL STATES. THIS IS BECAUSE SMALL STATES CANNOT SPREAD THEIR OVERHEAD EXPENSES OVER AS LARGE A SALES BASE AS CAN LARGE STATES. FOR THIS REASON, IT IS MOST MEANINGFUL TO COMPARE THE ALLOCATIONS FOR CALIFORNIA PROPOSED IN THE INITIATIVE TO THOSE OF STATES WITH LARGE URBAN POPULATIONS. IT IS ALSO IMPORTANT TO RECOGNIZE THAT STATES WHICH HAVE ONLY RECENTLY IMPLEMENTED LOTTERIES INITIALLY TEND TO HAVE UNUSUALLY HIGH EXPENSES AS A PERCENT OF SALES, BECAUSE OF SIGNIFICANT ONE-TIME START-UP COSTS FOR EQUIPMENT PURCHASES AND THE LIKE.

TABLE 3 INDICATES THAT THE DISTRIBUTION OF LOTTERY PROCEEDS IN MAJOR INDUSTRIAL STATES WITH WELL-ESTABLISHED LOTTERIES AND LARGE URBAN POPULATIONS IS APPROXIMATELY 49 PERCENT FOR PRIZES, 10 PERCENT FOR

TABLE 3
PERCENT DISTRIBUTION OF LOTTERY SALES
PROCEEDS IN 1983-84^A

STATE	PERCENT OF LOTTERY RECEIPTS ALLOCATED TO:		
	PRIZES	ADMINISTRATIVE EXPENSES	PUBLIC PURPOSES
ARIZONA	45%	26%	29%
CONNECTICUT	50	12	38
COLORADO	50	15	35
DELAWARE	47	11	42
ILLINOIS	48	8	44
MAINE	49	23	28
MARYLAND	51	8	40
MASSACHUSETTS	51	12	37
MICHIGAN	50	10	40
NEW HAMPSHIRE ^B	48	25	27
NEW JERSEY ^B	50	8	42
NEW YORK	44	13	43
OHIO	48	10	42
PENNSYLVANIA	49	9	42
RHODE ISLAND	50	17	33
VERMONT ^B	28	44	28
WASHINGTON	45	15	40
WASHINGTON, D.C. ^B	48	26	25
UNWEIGHTED AVERAGE FOR ALL LOTTERIES	47%	16%	36%
UNWEIGHTED AVERAGE FOR WELL- ESTABLISHED LOTTERIES IN MAJOR INDUSTRIAL STATES ^C	49%	10%	41%

- A. DETAIL MAY NOT ADD TO TOTALS DUE TO ROUNDING. ALL 1983-84 DATA ARE PRELIMINARY ESTIMATES OBTAINED THROUGH WRITTEN QUESTIONNAIRES AND/OR TELEPHONE CONVERSATIONS WITH STATE LOTTERY OFFICIALS.
- B. DATA ARE FOR 1982-83; DATA FOR 1983-84 WERE NOT YET COMPILED.
- C. INCLUDES THE STATES OF CONNECTICUT, ILLINOIS, MARYLAND, MASSACHUSETTS, MICHIGAN, NEW JERSEY, NEW YORK, OHIO AND PENNSYLVANIA. IF THE THREE WESTERN LOTTERY STATES OF ARIZONA, COLORADO AND WASHINGTON ARE INCLUDED, THE AVERAGE ALLOCATION OF LOTTERY PROCEEDS IS ABOUT 48 PERCENT FOR PRIZES, 12 PERCENT FOR EXPENSES, AND 39 PERCENT FOR PUBLIC PURPOSES.

ADMINISTRATIVE EXPENSES, AND 41 PERCENT FOR PUBLIC PURPOSES. THIS IS QUITE SIMILAR TO THE DISTRIBUTION IMPLIED IN PROPOSITION 37 FOR A FULLY-OPERATIONAL LOTTERY, TAKING INTO ACCOUNT THE FACT THAT PUBLIC EDUCATION WOULD RECEIVE BOTH UNCLAIMED LOTTERY PRIZES AND THE AMOUNT BY WHICH ADMINISTRATIVE EXPENSES FALL BELOW 16 PERCENT OF SALES.

6. STATE REVENUE LOSSES DUE TO THE TAX EXEMPTION ON LOTTERY WINNINGS

YOU HAVE ASKED WHAT OUR ESTIMATE IS OF THE INCOME TAX LOSS WHICH WOULD RESULT FROM THE EXEMPTION OF LOTTERY WINNINGS FROM STATE AND LOCAL TAXES, AS PROVIDED BY PROPOSITION 37.

RESPONSE

THIS QUESTION CAN BE VIEWED FROM SEVERAL DIFFERENT PERSPECTIVES. ONE SUCH PERSPECTIVE INVOLVES THE ISSUE OF THE INCOME TAX LOSS WHICH PROPOSITION 37'S EXEMPTION OF LOTTERY WINNINGS FROM INCOME TAXATION WOULD PRODUCE, RELATIVE TO THE AMOUNT OF TAX REVENUES WHICH WOULD BE COLLECTED IF LOTTERY WINNINGS WERE TAXABLE. THIS REVENUE LOSS WOULD DEPEND PRIMARILY ON TWO FACTORS:

- THE MARGINAL TAX RATES OF LOTTERY PRIZE WINNERS, AND
- THE EXTENT TO WHICH LOTTERY PRIZE WINNERS TAKE STEPS TO OFFSET THEIR LOTTERY-RELATED INCOME GAINS BY THE USE OF VARIOUS TAX SHELTERS.

THE LARGEST STATE PERSONAL INCOME TAX LOSS WOULD OCCUR FROM THIS PERSPECTIVE IF ALL LOTTERY WINNINGS WOULD NORMALLY BE REPORTED AS TAXABLE LOTTERY INCOME AND APPEARED ON TAX RETURNS SUBJECT TO THE STATE'S MAXIMUM MARGINAL TAX RATE OF 11 PERCENT. BASED UPON OUR ESTIMATE OF LOTTERY TICKET SALES UNDER A FULLY-OPERATIONAL LOTTERY (\$1.25 BILLION ANNUALLY), THE

MAXIMUM STATE INCOME TAX REVENUE LOSS WOULD BE ABOUT \$70 MILLION ANNUALLY. HOWEVER, THE ACTUAL LOSS WOULD DOUBTLESS BE MUCH LESS THAN THIS AMOUNT, SINCE NOT ALL LOTTERY PRIZE MONEY WOULD BE SUBJECT TO AN 11 PERCENT TAX RATE. ONE REASON FOR THIS IS THAT MOST PRIZES IN INSTANT LOTTERY GAMES ARE RELATIVELY SMALL (UNDER \$50), AND THEREFORE INCAPABLE OF AUTOMATICALLY PLACING A TAXPAYER INTO THE STATE'S MAXIMUM TAX BRACKET. IT IS ALSO IMPORTANT TO NOTE THAT IF CALIFORNIA IMPLEMENTED LOTTO-TYPE LOTTERY GAMES WITH MULTI-MILLION DOLLAR PRIZES, THE LOTTERY COMMISSION MIGHT DECIDE TO PAY THESE PRIZES OUT OVER A MULTI-YEAR PERIOD AS IS DONE IN OTHER STATES, IN WHICH CASE THE TAXES DUE ON THE PRIZES WOULD NOT BE COLLECTED IMMEDIATELY BUT RATHER WOULD BE SPREAD OVER TIME.

A SECOND WAY TO VIEW THE QUESTION OF LOST INCOME TAX REVENUES IS TO ASK HOW TOTAL STATE INCOME TAX REVENUES IN THE ABSENCE OF A LOTTERY ALTOGETHER WOULD COMPARE WITH TOTAL STATE INCOME TAXES IF PROPOSITION 37 WERE APPROVED. IN THIS CASE, TOO, THERE WOULD BE SOME UNKNOWN BUT PROBABLE LOSS IN STATE INCOME TAX REVENUES DUE TO PROPOSITION 37, ASSUMING THAT THE PRIZE-SHARE OF LOTTERY TICKET SALES WOULD, IN THE ABSENCE OF A LOTTERY, HAVE BEEN SPENT ON GOODS AND/OR SERVICES WHOSE PRODUCTION WOULD HAVE CONCURRENTLY GENERATED SOME TYPE OF TAXABLE INCOME. HOWEVER, BECAUSE WE HAVE NO WAY AT PRESENT OF KNOWING THE EXTENT TO WHICH LOTTERY TICKET SALES WOULD COME AT THE EXPENSE OF ITEMS WHOSE PRODUCTION CONCURRENTLY GENERATES TAXABLE INCOME, WE CANNOT ESTIMATE WHAT THE ASSOCIATED INCOME TAX REVENUE LOSS MIGHT BE.

7. THE EFFECT OF A LOTTERY ON PARIMUTUAL WAGERING REVENUES

YOU HAVE ASKED TO WHAT EXTENT, IF ANY, WE BELIEVE THAT THE PROPOSED LOTTERY WOULD REDUCE STATE REVENUES FROM PARIMUTUAL WAGERING ON HORSE RACING.

RESPONSE

WE BELIEVE THAT MOST IF NOT ALL FORMS OF GAMBLING HAVE AT LEAST SOME DEGREE OF SUBSTITUTABILITY FOR ONE ANOTHER, AND THEREFORE THAT ESTABLISHMENT OF A LOTTERY COULD CAUSE SOME LOSS IN STATE PARIMUTUAL HORSE RACING REVENUES. HOWEVER, BECAUSE HORSE RACING IS NOT MERELY A WAGERING ACTIVITY BUT ALSO IS A POPULAR SPECTATOR SPORT IN ITS OWN RIGHT, AND BECAUSE HORSE RACING WAGERING CAN INVOLVE CERTAIN HANDICAPPING SKILLS WHICH MANY BETTORS ENJOY PURSUING, WE WOULD BE SURPRISED IF THE NEGATIVE EFFECT OF A LOTTERY ON HORSE RACING WAGERING WAS PARTICULARLY SIGNIFICANT.

THE ACTUAL EMPIRICAL EVIDENCE ON THE WAY IN WHICH LOTTERY WAGERING AND PARIMUTUAL HORSE RACING WAGERING AFFECT ONE ANOTHER IS SKETCHY. ONE RECENT STUDY ON GAMBLING BEHAVIOR IN NEW JERSEY FOUND THAT THE PORTION OF LOTTERY PARTICIPANTS WHO ALSO WERE HORSE RACING PARTICIPANTS GENERALLY TENDED TO LIE BETWEEN 20 PERCENT AND 25 PERCENT, DEPENDING ON THE TYPE OF LOTTERY GAME, INDICATING THAT THERE WAS INDEED SOME POTENTIAL FOR "CROSS-OVER" BETTING BETWEEN THE TWO ACTIVITIES; HOWEVER, THE SPECIFIC EFFECT OF LOTTERY BETTING AND HORSE RACING BETTING ON ONE ANOTHER WAS NOT EXAMINED. IN OUR OWN STATISTICAL ANALYSIS OF WHY PER CAPITA LOTTERY SALES

VARY AMONGST STATES, WE FOUND THAT THE PRESENCE OF ALTERNATIVE LEGAL GAMBLING ACTIVITIES, SUCH AS PARIMUTUAL WAGERING, DOES IN FACT REDUCE LOTTERY SALES; HOWEVER, THIS EFFECT WAS NOT ESPECIALLY STRONG. GIVEN THIS SKETCHY EMPIRICAL EVIDENCE, WE RECENTLY CONTACTED THE STATE HORSE RACING BOARDS IN EACH OF THE FOURTEEN LOTTERY STATES WHICH ALSO PERMIT PARIMUTUAL WAGERING ON HORSE RACES. ELEVEN OF THE FOURTEEN STATES REPORTED THAT THEY FELT THEIR LOTTERY HAD EITHER NO EFFECT OR ONLY A NEGLIGIBLE EFFECT ON THEIR PARIMUTUAL WAGERING; THE REMAINING THREE STATES WOULD NOT RULE OUT THE POSSIBILITY THAT THEIR LOTTERY MIGHT HAVE HAD SOME EFFECT, BUT HAD NO SPECIFIC DATA TO SUPPORT THIS CONCLUSION AND DID NOT BELIEVE THAT THE EFFECT WAS PARTICULARLY SIGNIFICANT. THUS, WE ARE NOT AWARE OF ANY "HARD" EVIDENCE THAT THE EXISTENCE OF LOTTERIES NOTICEABLY REDUCES PARIMUTUAL HORSE RACING REVENUES.

8. INDIRECT FISCAL EFFECTS

YOU HAVE ASKED WHETHER ANY INDIRECT FISCAL EFFECTS MIGHT RESULT FROM A STATE LOTTERY, INCLUDING THE POSSIBLE LOSS OF SALES TAX REVENUES IF THE PURCHASE OF LOTTERY TICKETS DIVERTS DISPOSABLE INCOME FROM BEING SPENT ON TAXABLE GOODS.

RESPONSE

THE ANSWER TO THIS QUESTION IS "YES"--THERE UNDOUBTEDLY WOULD BE CERTAIN INDIRECT FISCAL EFFECTS RESULTING FROM THE ESTABLISHMENT OF A STATE LOTTERY. INDIRECT FISCAL EFFECTS ARE USUALLY AN INEVITABLE CONSEQUENCE OF

ANY TYPE OF MAJOR CHANGE IN THE PRODUCTION AND CONSUMPTION OF GOODS AND SERVICES IN AN ECONOMY, ESPECIALLY WHEN, AS IS ESSENTIALLY THE CASE WITH PROPOSITION 37, AN ENTIRELY "NEW" COMMODITY IS CREATED.

IN THE CASE OF A STATE LOTTERY, THERE CERTAINLY COULD BE SOME LOSS IN SALES TAX REVENUES TO THE EXTENT THAT SOME PORTION OF THE WELL-OVER \$1 BILLION PROJECTED TO BE SPENT ANNUALLY ON LOTTERY TICKETS WOULD OTHERWISE HAVE BEEN SPENT DIRECTLY ON TAXABLE GOODS. OF COURSE, TO THE EXTENT THAT THE LOTTERY RESULTS IN INCREASED EXPENDITURES ON LOTTERY EQUIPMENT, EDUCATIONAL SUPPLIES AND OTHER SUCH ITEMS, THERE COULD ALSO BE CERTAIN POSITIVE SIDE-EFFECTS OF THE LOTTERY ON SALES TAX REVENUES.

OTHER TYPES OF EFFECTS WHICH THE PROPOSED STATE LOTTERY MIGHT PRODUCE COULD INCLUDE CHANGES IN THE DISTRIBUTION OF AFTER-TAX INCOMES OF INDIVIDUALS (THIS WOULD DEPEND ON THE EXTENT THAT LOTTERY PARTICIPATION WOULD VARY AMONGST INCOME GROUPS), CHANGES IN THE PATTERN OF INCOME FLOWS BETWEEN CALIFORNIA AND OTHER STATES (THIS WOULD DEPEND ON SUCH FACTORS AS WHERE LOTTERY EQUIPMENT WAS MANUFACTURED AND TO WHOM LOTTERY OPERATING PROFITS ACCRUED), AND CHANGES IN EMPLOYMENT IN THOSE INDUSTRIES WHOSE OUTPUT MIGHT BE CHANGED BECAUSE OF A REDIRECTION OF CONSUMER SPENDING INTO LOTTERY WAGERING.

